The New York Certified Public Accountant

VOL. XXI — *February · 1951* — No. 2

Society and Editorial Offices: 677 Fifth Avenue, New York 22, N. Y.

BOOK REVIEWS

Advanced Accounting, Volume II

By George H. Newlove and S. Paul Garner. D. C. Heath and Company, Boston, Mass., 1950. Pages: xi + 418: $4.50.

Advanced Accounting, Volumes I and II, represent the fifth and sixth texts in the Heath Accounting Series,—Volume II being published in advance of Volume I (titled Corporate Capital and Income) which is scheduled for publication in 1951. Volume II, it is stated, does not presuppose study of Volume I.

Advanced Accounting, Volume II, deals with:

1. *Corporate reorganizations.* Refinancings, recapitalization, and exchanges of property and securities; and voluntary liquidations, inclusive of the Realization and Liquidation account, presented in several styles. Considerable emphasis is given to the role which the accountant fills in his relationship to the work of the Corporate Reorganization Division of the Securities and Exchange Commission.
2. *Bankruptcies,* inclusive of involuntary reorganizations, the statement of affairs, valuation problems, statutory considerations, and the accounts and reports called for under the National Bankruptcy Act.
3. *Fiduciaries,* inclusive of estate and trust accounting.
4. *Partnerships.* Formation, operation, dissolution, incorporation; joint ventures and syndicates.

The authors state that it is their desire to emphasize the "advanced accounting" aspects of the first 3 sections, above. For purposes of orientation, they reinforce their discussion with considerable statutory and judicial information and references.

The book endeavors to incorporate complete coverage of the bulletins of the American Institute of Accountants, the pronouncements of the American Accounting Association, and the releases of the Securities and Exchange Commission.

Accompanying the book is a manual on Advanced Accounting Problems, ($2.00), designed to give adequate problem coverage of the accounting principles developed in the text.

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Book Reviews

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Cost Accounting and Analysis

By Carl Thomas Devine. The MacMillan Company, New York, N. Y., 1950. Pages: xv + 752; $5.00.

This book by Professor Devine is more than just another textbook. It is a type of presentation in the field of cost accounting that has been due for some time. It attempts three things:

1. To present the rationale and the mechanics of cost accounting.
2. To integrate economic and cost accounting theory.
3. To relate industrial engineering principles to cost accounting and the problems of management.

These three objectives more or less overlap. Although the book is divided into three sections, that does not mean that each section is devoted to one of the above objectives. Actually the first section, covering twelve chapters, presents the general principles of cost accounting including elements of cost, departmentalization, process, job order, and joint product costing, as well as historical and predetermined costs. The second section consists of seventeen chapters, and these are devoted mainly to a presentation of the bookkeeping aspects of cost accounting. Here we find the mechanics of the factory ledger, of all phases of material accounting and of labor costing. By all odds the most important feature of this section is the extended treatment given to standard costs. The section closes with a chapter on gross profit variations and one on distribution costs.

It is the third section that is of most interest, particularly to the advanced student of cost accounting. The theme song of this section is profit planning. Here the author attempts to present solutions to some of the many problems confronting modern executives. This he does by alternately discussing the contributions made by economic theory on the one hand, and the discoveries made by industrial engineers on the other. The questions treated cover the nature of costs, optimum output, break-even points and profit-graphs, differential costs, and comparative costs involved in questions of choices between alternatives. The latter include such problems as selection of plant size and type, plant shutdowns, pricing policy, etc. An interesting feature is the presentation of mathematical methods for analyzing fixed and variable components of expenses including the least-square method and correlation analysis. The mathematical background of the author is obvious.

The value of the entire volume is greatly enhanced by the wealth of question and prob-

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lem material at the end of each chapter as well as by the demonstrations appearing in various parts of the book. Many of the problems are from C.P.A. or other professional examinations, wihle many others are drawn from the author's experience.

To appraise such a work objectively is a difficult task, for much depends on the reviewer's personal feelings and background. The author must be given credit for having attempted to integrate the highly theoretical field of economic theory with the practical exigencies of cost accounting and industrial engineering. To this reviewer, the economic theory serves only a limited purpose, since economics must deal in generalizations while the problems of the cost accountant and of the industrial engineer are pinpointed to the specific conditions of a particular enterprise. It would be easy also to disagree with the author on a number of points and to find flaws and even errors in the work. For example, why introduce the budget at standard volume (pp. 501-504) when no use is made of this figure in computing the expense variances? Nevertheless, it seems to this reviewer that the author has broken away from the traditional methods of teaching cost accounting. By taking advantage of the great mass of magazine literature in the field of economic theory, industrial engineering, and cost accounting, the author has made a valuable compilation and has brought together the thinking of the scholar and the practitioner. If the author at times has fallen short of his objectives it is perhaps because he has been too faithful a compiler. For instance, the early portion of the chapter on gross profit variances does little more than present the methods of G. Charter Harrison and Eric Camman and these with a minimum of explanatory material. Nevertheless, one must conclude that the whole effort in this book has been worth while and that the book is a worthy addition to the literature of cost accounting.

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C.P.A. Law Review

By Joseph L. Frascona, LL.B. RICHARD D. IRWIN, INC., Chicago, Ill., 1950. Pages: xvi + 986; $10.00.

This volume is designed to "assist the candidate both in the acquisition and in the application of knowledge" necessary to pass the Commercial Law part of the Uniform Certified Public Accountant Examination promulgated by the American Institute of Accountants. Four hundred eighty pages consist of text materials on Contracts, Sales,

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THE NEW YORK
CERTIFIED PUBLIC ACCOUNTANT

EMANUEL SAXE, *Managing Editor*

The matters contained in this publication, unless otherwise stated, are the statements and opinions of the authors of the articles, and are not promulgations by the Society.

VOL. XXI *February • 1951* No. 2

President's Message

WE are entering what promises to be one of the most critical years our country has ever been through and it will probably be one of the busiest years our own profession has ever experienced. The problems will be multiplied and the number of men to handle them will diminish rather than increase.

We all know the problems: excess profits taxes; renegotiation; government guaranteed loans; businesses operating under priorities; price freezes; wage freezes; and all the other government controls and orders with their attendant red tape and paper work.

Many young accountants will be called into service. Men in college, who would on graduation become juniors, will go into the armed forces and many experienced men will take government positions. Those of us who are left will need to work harder and will need to use our time to the best advantage possible. The profession will meet the challenge now as it has done in the past, no matter what the difficulties.

In spite of all this there seems to be a tendency among those of us who are merely doing our daily work, or a little more than our daily work, to wonder whether what we are doing is really important enough to warrant the expenditure of so much time and effort on work not directly connected with the emergency which now confronts us.

Our daily work is essential to keep commerce and industry operating. A sound economy is the basis of everything else the nation must do. Therefore, when the accountant is helping a small client to run his business better, to plan his budget, and to pay no more than his legal taxes, he is doing his share, small in itself, perhaps, to keep the economy operating. When we add ten thousand or a hundred thousand of these small businesses together, all of which are kept on the straight and narrow financial path by their accountants and auditors, we can see what an important place the accountant's work has in keeping the whole economy in operation.

In this emergency it is even more important than in more nearly normal times for the general economy to be sound and responsive to public needs. The everyday work of the public accountant, serving private clients, is essential in maintaining this condition.

MAURICE E. PELOUBET

Pointers on the Technique of Writing Audit Comments

By Jennie M. Palen, C.P.A.

To write really good comments in an audit report is a peculiarly difficult and frustrating task; difficult because involved technical matters must be expressed in language understandable by persons without comparable technical training; frustrating because the auditor's major concern is with auditing, not writing; frustrating, also, because his need for exactness is so great that his writing must be heavily censored.

This situation is not conducive to confidence in one's writing ability. Yet the accountant, who must always think clearly and has a flair for taking pains, should write superlatively well. Some accountants have made a mental hazard of writing, believing there is some antagonism between it and accounting. If this were true, the great body of our splendid accounting literature would never have been written.

We all learned early in life the rudiments of grammar—or where to find them. We learned how to spell—or where to look for correct spellings. With these preliminaries, one or two good reference books, and an unabridged dictionary, the accountant is as well equipped as he needs be to write *correctly*. With practice and love of his task, style and effectiveness, too, may be his.

Because, in an audit report, we are writing about our client's innermost financial affairs, what we write should, theoretically, interest him. We cannot hold his interest, however, if we talk all around the subject, load our comments with trite, abstract, and meaningless words, and in general act as if we are bored with the whole thing. And we are not bored really. We have reached a point in our work where we have a great many important things to say and we are bursting to say them, but we are bothered by the mechanics of putting them down on paper.

This problem is especially acute in the long-form report where the comments are lengthy and where verifications are described and breakdowns given under the heading of various asset, liability, and operating accounts.

To recast a certain number of sentences so that *we* will not be the first word in thirty per cent of them; to find interesting variants for the ubiquitous *this item, this amount consists of the following,* etc.; in short, to make the comments sound as if they had been written out of the warmth of our own thinking and not from last year's copy, is one of the toughest jobs in report writing.

The crystallization of the idea that a certificate should always be given where possible has offered one solution to this problem by making it unnecessary to describe all the audit procedures unless it is desired to do so. Even where the audit procedures are described in detail it is feasible sometimes to group their

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description in one long paragraph and to place the more interesting comments where they will receive better attention, either under individual asset or liability headings or under such other headings as may be appropriate.

Total wordage may frequently be reduced by expressing pertinent facts in the exhibits. If, for instance, one item in trade accounts receivable is so large that it is desirable to name the debtor, the accounts may be shown in the balance sheet thus:

Trade accounts receivable:		
John Jones Company	$95,000.00	
Other	5,000.00	$100,000.00

Sometimes all information may be included in the balance sheet description. Here is a sample found under liabilities:

> "Unpaid portion of 1947 Federal income tax of predecessor company, awaiting adjustment of claim for abatement."

Of course, the balance sheet should not be cluttered with useless detail, but usually both financial statements and comments are improved by pressuring needed information into condensed form.

Except possibly for certain phrases which are so exact that there is no usable substitute for them, the wording of comments cannot be reduced to formula. To do so would be to defeat their real purpose, which is to call attention to significant matters and new developments. Certain expressions have proved their worth, such as, "cash on hand was counted and that on deposit was verified by certifications obtained from depositaries," "funds held by agents were acknowledged by them," "notes receivable and the collateral shown to be held thereunder were confirmed by the makers," etc. But even these are not uniform throughout the profession. There are, however, typical accounting situations and typical pitfalls in reporting them. Knowledge of accounting and a basic knowledge of the principles governing grammatical construction and the use of words, will solve them.

George Burton Hotchkiss has defined the five "C's" of business English as, in the order of their importance, clearness, correctness, conciseness, courtesy, and character. But for accountants the list should include another "C", and that is caution.

An audit report is a signed, written record, a permanent document, and a serious matter. Money is lent or permanently invested on the basis of its showing. Sometimes people are sued because of it and sometimes those people are the auditors. Not only in the financial statements but in the wording of the comments care is needed to insure that nothing is said that cannot be supported in court. Where defalcations are reported the problem is especially difficult. No unnecessary personal references should be made and the words should express only such evidence as the books support. Dates, names, and book entries, where quoted, should be quoted exactly, including even any erroneous spellings, and photostat copies of canceled checks and other records are frequently made a part of the report. Usually a defalcation report consists only of comments, unless there are numerous irregularities of a similar nature, so that exhibits and schedules may be used to advantage. The comments may effectively present a summary, then details, then a description of the manner in which the defalcation was brought about. A sample report reads as follows:

> "We have made an examination of certain of your records for the period from May 1. 1949, to March 26, 1950, for the purpose of establishing the extent

of irregularities disclosed during the course of our examination for the year ended January 31, 1950.

"Total irregularities amounting to $8,540 were found, as follows:

Collections on accounts receivable not accounted for	$5,230
Checks drawn to J. Smith and charged to expense, not supported by vouchers or other receipts	3,310
Total	$8,540

"The collections on accounts receivable not accounted for are as follows:

....

....

"It appears that the method used to conceal these irregularities was to make a credit entry in the customer's account for the amount of the collection, but to make no corresponding entry in the cash book at the time of receipt, inserting these amounts in the cash book after it had been footed by an assistant. Trial balances were submitted each month but were overfooted to agree with the controlling account."

In the hope that it will afford practical assistance, discussion of Mr. Hotchkiss' five "C's" will be based entirely on examples of violations lifted from rough drafts of reports and from published or typed reports of many accounting firms. None of these has been manufactured to serve as a horrible example. Most of the reports from which they were taken were written by accountants of senior or higher grade and they may therefore be regarded as fair samples of the points which give the most trouble.

Courtesy and character, being easily defined, will be covered first.

Courtesy implies the use of tact in expressing that which may offend. As accountants we must, unfortunately, criticize—and in practice it is found that the mildest criticism can release untold furies. Of course, important truths may never be withheld just because they may be unpalatable to the client, but they may be stated in as inoffensive a manner as is consistent with truthfulness. Words and phrases with unpleasant connotations such as *errors, mistakes, wasted time, shortage, carelessness, inefficiency, refusal,* etc., can become fighting words, not to say dangerous ones, and it is well to learn early in life harmless yet effective substitutes to use on occasion.

Criticisms are more welcome when they dwell on the cure rather than on the crime. For instance, instead of saying, "Too many accounts are carried in one ledger and, as a result, a great deal of time is wasted in looking for errors at the end of the month," we may say, "Much of the checking incident to balancing could be avoided if the accounts were divided into several sections with a controlling account for each section."

The character desired in a report (other than that imparted by the very important factor of technical accounting knowledge) is obtained by the use of a dignified, impersonal tone. Dignity, however, is not enhanced by suffocating our ideas in yards of such cotton-wool expressions as "in the case of," "with respect to," "of this character," "of this nature," etc. It is occasionally convenient to use these expressions but tone and vigor are greatly improved by recasting sentences to avoid their constant use. Neither is dignity enhanced by such phrases as "not without interest," "venture to state," "wish to inform," etc. "We wish to inform" and "we would suggest" are apparently occupational hazards of the business writer. Why wish to do something which we are already doing? Let's use simply "we suggest" or "it is suggested," or, better still, no introductory phrase at all. We may say, for instance, "Monthly summaries of sales, by products, would give an up-to-the-minute picture of consumer buying," rather than "We should like to suggest the preparation of monthly statements

showing the nature of the sales as to type of product for the use of officials in appraising the character and volume of customers' requirements." Here are 35 words where 17 do a better job, and even the 17 may be reduced to 14 by using *current* for *up-to-the-minute.*

Archaic or flippant expressions, foreign words, slang, figures of speech, the half sentence have small utility in the audit report. To be good, writing should be appropriate. To be offhand in an audit report is not only inappropriate, it may be downright foolhardy. If anything in an audit report is vague, inaccurate, or subject to more than one interpretation, if it contains non-dictionary words which cannot be defined, serious trouble may result.

Clearness, correctness, and conciseness, the remaining three qualities, are so important that every sentence in the report should be tested for their presence.

Clearness means not only that each statement can be understood but that it cannot reasonably be misunderstood. Correctness relates to both subject matter and the manner in which it is expressed. The facts must be exactly as stated; the construction must conform to the rules of grammar; and the words must be used in their exact sense. Conciseness requires that every thought be expressed in as few words as is consistent with smoothness and completeness. Conciseness is not to be confused with brevity. Many people, in their desire to be brief, leave out important facts or omit words necessary to the construction. Conciseness never requires the omission of things of value, but does require omission of the valueless or relatively unimportant.

The best aid to clarity is good sentence structure. Strong, direct sentences in which the ideas are logically arranged make for clearness. The principal idea in the sentence should occupy the principal clause. Important sentences and first sentences of paragraphs should not have weak beginnings.

If one of the ideas is subordinate to the other they should be joined by connectives which will express the proper relationship. Note the weakness of this sentence: "Only a few entries of deposits made or checks drawn appear on the stubs, but the bank account is active." Then see how the proper connective improves it: "Although the bank account is active, only a few entries of deposits made and checks drawn appear on the stubs."

Changing the viewpoint within the sentence weakens its effect. When we say, "The entries in the property account were examined and appear to be proper," the thought runs smoothly through the sentence; but if we say, "We examined the entries in the property accounts and they appear to be proper," the thought is slowed by shifting attention from *we* to *they.*

Parallel ideas in a sentence should be put, as a rule, in parallel construction. The phrase, "due to carelessness on the part of clerks and because supervision is lacking," is weak and shambling, whereas "due to carelessness on the part of clerks and to lack of supervision" is effective.

On the other hand, confusion is assured when long sentences continue until their beginning is forgotten, when clause is tacked on to clause and modifier on to modifier. Here is such a sentence:

> "We have reconciled the accounts with the various correspondent banks, and in this connection, during the course of examination while endeavoring to effect a reconciliation with correspondent banks, our representative, working in conjunction with Mr. Jones of the bank's accounting department, developed the fact that the chief teller of the commercial department had taken credit for amounts which should have been credited to the X Bank of New York."

All the writer needs to say here is:

> "Reconcilement of the accounts with correspondent banks disclosed the fact that certain amounts which should have been credited to the X Bank of New York were, instead, credited to the account of the chief teller of the commercial department."

Confusion also arises through poor placing of modifiers. Each modifier

should be so placed that the reader sees unmistakably to what word or group of words it refers. *Only* is a word frequently misplaced. "Expenses only include one-half the sales manager's salary." Since *only* relates to *one-half* and not to *include,* the sentence should read: "Expenses include only one-half the sales manager's salary."

When we write that "these charges are regarded as collectible by the treasurer," the reader is justified in inferring that only the treasurer can collect them. With correct placing of the modifier the sentence reads, "These charges are regarded by the treasurer as collectible." Please note, too, the ambiguity that results if the reference to the treasurer is omitted. The inference then is that the accountant regards the charges as collectible. The same care should be applied in using the word *estimated.* The responsibility for the estimate, as well as its basis, should be established.

The use of specific rather than general terms is an aid to clearness. *Real estate,* for instance, is an ambiguous term because it may mean land, buildings, or both.

Clearness is hindered by a poor arrangement of ideas, as in this sentence:

> "During the period depreciation was charged to operations at the following rates for nine months . . ."

It is not clear here whether the rates were for nine months or whether they were yearly rates of which a nine months' proportion was taken. The sentence would be clear if it read as follows:

> "During the nine months under review depreciation was charged to operations at the following annual rates . . ."

A little care in thinking will warn us not to speak of the book value of an asset account, but of the book value (or carrying value) of the asset. It is not the accounts receivable which are in agreement with the controlling account; it is the total of the individual balances which is in agreement with the controlling account. A company does not "transfer assets *contained* in schedule 1;" it "transfers assets *listed* in schedule 1." Neither does it "charge off the balance of live stock account disposed of," since, undoubtedly, it was the live stock that was disposed of, not the account.

Next in importance to clearness is grammatical correctness.

Experience shows that certain types of grammatical errors appear over and over.

Tense is a major stumbling block. The past tense is the tense of narration. We usually use it in telling what we did. When we write the certificate we are giving a current opinion based on work completed. So we use the present perfect tense to describe the work ("We *have examined* . . .") and the present tense in certifying ("in our opinion the accompanying . . . *present* fairly . . ."). Similarly, in a presentation we say, "We *have made* an examination . . . and *submit* . . .," the act of submittal being assumed to take place on the day the report is dated.

When it is necessary to refer to action completed prior to the time indicated by the principal verb, usually the past perfect is used with the past tense and the present perfect with the present tense; as, "Reconcilement of the bank account *disclosed* that it *had* not *been reconciled* since March 31, 1950;" and "We *understand* that the new company *has agreed* to take over these assets at book value;" but "We *understand* that, prior to negotiations with the bankers, the new company *had agreed,* etc. . . ." There are, however, a great number of combinations of tenses and we have to use our judgment to determine which combinations best express the relationships.

Truths that continue into the present should be expressed in the present tense. "We were informed by the treasurer that the payrolls *are disbursed* by the foremen each Friday morning."

A verb should agree in number with its subject noun, not with an intervening modifier. Thus we say, "the total

of accounts receivable differs. . . ." *Differs* agrees with its singular subject *total,* not with *accounts.*

A singular subject, although followed by a parenthetical phrase, takes a singular verb. In the sentence, "The amount of this note, together with the pledge as collateral thereto of 15 shares of A Company stock, were confirmed by the bank," *were* is incorrectly used because the subject is *amount* and the phrase *together with the pledge, etc.* is a modifying phrase, not another subject. The sentence should read, "The amount of this note, together with the pledge as collateral . . . was confirmed . . ." Words joined to the subject by such expressions as *in addition to, as well as, with,* or *together with* are parenthetical and do not constitute another subject.

Two or more singular nouns joined by *or* or *nor* take a singular verb, and two or more subjects of a different number joined by *or* or *nor* take a verb of the number of the nearest subject. Thus we should say, "Neither the sales records nor the cash book contains a record of this transaction."

Principal verbs should not be supplied from one part of the sentence to another if the same form is not grammatically correct in both parts. Observe how this principle is here violated: "$2,000 has been paid in cash on this subscription and twenty shares of stock issued therefor." If we try to supply from the first clause the part of the verb that is missing from the second clause we have this result: "twenty shares of stock has been issued," which is, of course, wrong. The sentence should read: "Two thousand dollars has been paid in cash on this subscription, and twenty shares of stock have been issued therefor."

The foregoing sentence is also an illustration of the rule that *dollars,* when it refers to a sum of money, takes a singular verb.

A common error is that of using a participle to introduce a sentence when it does not logically modify the subject of the sentence. "Based upon our review of the accounts with the credit manager, all appear to be collectible." "Having reviewed the accounts with the credit manager, all appear to be collectible." Each of these sentences has a dangling modifier—a modifier with nothing to modify. They should be revised to read: "Based upon our review . . . our opinion is that the accounts are collectible;" "Upon the basis of our review . . . all appear to be collectible;" "Having reviewed . . . we believe that all are collectible;" or (preferably) "The accounts were reviewed with the credit manager and appear to be collectible."

Almost as common is the error of comparing two things without naming the second. "The method of control used is better than all methods in use" should of course read, ". . . than all *other* methods in use." And the sentence which read, "There is a difference of $100 between the bank balance as shown by the company and the bank" should have read, ". . . between the balance as shown by the company and that shown by the bank."

The placing of commas gives rise to many questions. In general, marks of punctuation should be used where they will facilitate reading and where they will maintain proper sentence and thought values. The comma, since it represents the shortest pause, is especially flexible in its use. It may always be used where it will aid clarity. One comma rule that is inflexible, however, is that a relative noun clause which is restrictive in meaning should not be set off by commas. If we say, for instance, "The factory expenses were distributed on the basis of the cost of materials *which were used in manufacture,"* we here have a restrictive clause and need no comma after *materials.* A comma placed there would imply that the distribution was on the basis of the cost of *all* materials, and that all materials were consumed.

A large proportion of the errors in reports arises from the incorrect use of words.

Confusion apparently exists as to the proper use of *quantity, amount,* and *number.* A moment's thought will indicate which word applies. In the sentence, "A large amount of lumber is stored under the sheds and not controlled," it is obvious that the proper word is *quantity* and not *amount.* On the other hand, in this sentence, "The contract calls for the sale of stock in quantity up to $1,000,000," it would clearly be better to say, "to a total amount of $1,000,000." And instead of saying, "A considerable amount of changes will be required," we should certainly say, "A considerable number of changes . . ."

An accountant should also remember that assets are *collected* and that liabilities are *paid;* expenses are *incurred,* income *realized;* and that we speak of *realization* of assets, *liquidation* of liabilities.

It is poor usage to employ *same* as a pronoun ("We checked the charges and found *same* to be correct"); *said* as a participial adjective ("The securities are held by X Bank as collateral and were confirmed by *said* bank"); or *party* for *person.*

Advise is employed to excess in the sense of *inform.* Many people say *advise* on every possible occasion and the word has become hackneyed in the extreme.

Former and *latter* should not be used to designate one of more than two persons or things. To designate one of three or more say *first* or *first-named,* and *last* or *last-named.* In the sentence, "The operations were conducted during only the latter nine months of the year," *latter* should be *last,* because we are speaking of nine of twelve months.

Verbal is often improperly used for *oral. Verbal* means *expressed in words. Oral* means *spoken.* Thus we should say, "The amount of this liability was confirmed to us *orally* by the creditor," not "confirmed to us *verbally* . . ."

The word *confirm* is a source of trouble. In the accountant's lexicon, confirmation is corroborative evidence obtained from another. It is technically inexact to say that "we *confirmed* customers accounts." It is better to say that "requests for confirmation of the balances shown in their accounts were mailed to customers." Sometimes an auditor even errs so badly as to say that *"confirmations* were mailed to customers," confusing the *form* used in asking corroboration with the confirmation itself.

Care should be taken that assets (or liabilities) are not spoken of as *secured* when they are in fact only partially secured. Where, for instance, securities having a value, based on market quotations, of $8,000 are held as collateral under a $10,000 note receivable, it is a misstatement to say that the note is *"secured* by 100 shares X Company capital stock." In such a case we can say no more than that the note is *"partially* secured by pledge of 100 shares X Company capital stock, having a value of $8,000 based on market quotations at December 31, 1949." Or, if the market value is not determinable, we may say that "One hundred shares X Company capital stock are held as collateral to this note. We were unable to determine the market value of the stock." (*One hundred* is spelled out here because it is at the beginning of the sentence.)

The correct use of prepositions requires some care. An unabridged dictionary usually indicates the prepositions to be used after words in specific meanings.

It is correct to say "subscriptions *for* capital stock," "subscriptions *for* periodicals," but "subscriptions *to* a fund."

Between is used in speaking of two things; *among,* when speaking of more than two; as, "A varying percentage of the profits is divided among the heads of departments;" "The responsibility for the petty cash is now divided between the cashier and the bookkeeper."

After *site, of* is used where the object is already located on the site. *For*

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Form and Content of the Accountant's Report

By Robert G. Koeppel, C.P.A.

The professional services which independent public accountants render to their clients result generally in the preparation of a report in one form or another. The accountant's report may consist solely of his certificate or opinion (now commonly referred to as the short form of auditor's report) with respect to the related financial statements, or it may comprise the foregoing together with certain text material or comments. This latter type of report is generally known in present-day accounting parlance as the long form of auditor's report or comment report. In addition to these two aforementioned reports, which, for purposes of this discussion, may be termed general reports, the accountant is frequently called upon to furnish special reports with respect to certain cost studies, systems' installations, special investigations, and the like.

The subject of audit reports is one of wide scope and would require considerably more time for proper treatment if we were to consider the aspects of all types of audit reports. The following discussion will, therefore, be confined to the technique in preparing the text or comment portion of a long form report which is to be rendered at the conclusion of an audit of the balance sheet and operating accounts for a commercial or industrial enterprise. For purposes of clarity, wherever the word "report" is used hereinafter, it should be construed to mean the long form or comment report, and the word "certificate" will be used wherever reference is made to the short form of auditor's report.

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This paper was read at a technical meeting of the Society, held under the auspices of the Committee on Auditing Procedure, at the Engineering Societies' Building on October 26, 1950.

I believe that it can safely be said that accountants as a group do not take full advantage of the opportunity presented for service to their clients in the rendition of comment reports. It is probably quite true in the case of large audit engagements, that management is interested principally in the accountant's certificate, and that the executives have been kept adequately informed on accounting and financial affairs during the year by means of statements and reports furnished periodically by their internal organization. In the case of medium and small-sized engagements, the independent public accountant can render valuable service to his clients by preparing informative and interesting comment reports, and a similar worth-while service can just as well be rendered, if desired by the client, in the case of the larger engagements.

Accountants are well qualified to make analyses and interpretations of financial statements and to evaluate significant facts indicated by them. We may be rendering a disservice to our clients and shirking our obligations if we consider that our job has been done as soon as the ink has dried on our signature on the certificate. There

should be little doubt in anyone's mind that the value of our services can be enhanced considerably by undertaking to perform a service for which we are so adequately qualified. It is, of course, true, that in many instances the client requests that a certification only to the financial statements be furnished, but it is also true that there are few cases where the client's instructions specify that we are not to render a comment report. In almost all engagements there develops during the progress of an audit something of sufficient importance to justify its being brought to the attention of the client, and intelligent application of our efforts to the end that this information should be furnished will in almost every instance be appreciated.

The writing of comment reports is considered by some accountants to be an arduous and unrewarding task. Perhaps it is a fault of our present-day educational system, together with a certain amount of neglect within the accounting profession itself, that sufficient importance and emphasis has not been given in the teaching and training curriculum to the writing of clear, concise, and informative comment reports. Some accountants have made the observation that good report writers are born and not made, but I believe that where the necessary emphasis has been placed on good report writing and adequate training given, experience has shown the fallacy of this platitude.

In preparing the comment report, a combination of discriminating judgment in the selection of items that are to be discussed, and an adequate knowledge of good English usage and grammar is essential. In connection with the selection of items that are to be made the subject of comments, one should consider briefly the purpose for which the report is to be used. If it is the desire of the client to utilize the report for credit purposes, emphasis should be placed on such matters as the aging of receivables, current asset and current liability ratios, inventory turnover, etc., and little concern need be given to the audit procedures followed or to suggestions relating to changes in accounting methods and proedures. If the engagement is a new one, it might be in order to discuss more fully the steps performed in verifying certain accounts; this is especially true where the person who is to receive the report is not familiar with the auditing procedures employed by independent accountants. In fact, clients sometimes prefer that specific reference be made, either in the certificate or in the comments, to the verification of cash, inventories, etc.

It might be well at this point to inject a note of caution in respect of the general nature of the comments that are to be included in the report. A report consisting of voluminous comments may at first blush appear to be imposing and important, but if the comments deal at considerable length with trivia and unimportant and uninteresting minutiae, the report would have little value to the client and probably should not have been written in such form.

The importance of a neat and orderly arrangement of the report should not be minimized. It is generally appropriate, especially where the report is of considerable size, to include an index or table of contents at the beginning of the report. The index should indicate, by page reference, the various items contained in the report, which usually appear in the following order:

a. Comments
b. Accountants' certificate
c. Financial statements and schedules

Each caption in the comment section should be repeated in the index, and the financial statements, consisting generally of a balance sheet and a statement of income and earned surplus (either shown as separate statements or combined into one statement), may be indicated further by some reference such as Exhibit A, Exhibit B, etc. The supporting schedules, which are some-

times utilized to present the details of certain balance sheet and income statement accounts are usually described as Schedule 1, Schedule 2, etc.

Comments are usually preceded by an introduction, commonly referred to as a presentation, which may read somewhat as follows:

> XYZ Corporation,
> New York, N. Y.
>
> Dear Sirs:
>
> We have made an examination of your accounts for the year ended December 31, 1950, and present our certificate, and the financial statements as set forth in the accompanying index.
>
> We present also the following comments:
>
> * * *

If the report is not too large, the index may be dispensed with, and reference to the statements and schedules included in the presentation somewhat as follows:

> We have made an examination of your accounts for the year ended December 31, 1950, and present our certificate and the following financial statements:
>
> Balance Sheet, December 31, 1950 (Exhibit A)
>
> Summary of Income and Earned Surplus for the Year Ended December 31, 1950 (Exhibit B)
>
> We present also the following comments:
>
> * * *

It is sometimes desirable to incorporate the accountant's certificate in the body of the comments. If this is done, it is preferable to show the opinion immediately preceding the comments. If the comments are placed between the scope paragraph and the opinion paragraph of the accountant's certificate, it is necessary for the reader to read all of the comments in order to determine whether or not the accountant has given an unqualified opinion. If the presentation form of certificate is used, and the certificate is qualified in any manner, reference should be made to the specific comments which explain the exception taken by the accountant. It is not correct to say that, "In my (our) opinion, subject to the following comments, . . .". The average readers of accountant's reports, and in some cases other accountants themselves, may not be able to determine which comments are of sufficient importance to require a qualified opinion. Where no opinion, or a disclaimer of opinion is given, it is incumbent upon the accountant to indicate the specific reasons therefor.

Having decided upon the manner in which the certificate is to be shown, the accountant is confronted with the problem of the order in which his comments are to be presented. Generally, the question of determining the order in which the comments are to be presented is a matter to be resolved in the light of the particular circumstances of each report. Where the report is rendered at the conclusion of an initial engagement, or where it is contemplated that the report will be used by a prospective purchaser of the business, a brief history of the concern should undoubtedly be given first. In reports for subsequent years this information would no longer be of any importance and should not be repeated, but comments regarding any important changes occurring in the organization during the period under review, such as a reorganization, the acquisition of a new subsidiary, or the funding of a pension plan for employees, should generally be commented upon first.

Although the accountant should submit comments with respect to important matters only, some items may take precedence over others from the standpoint of importance, and should possibly be shown first regardless of the order in which they may appear in the financial statements.

If none of the aforementioned factors are to be considered as influencing the auditor's intentions insofar as the arrangement of comments is concerned, the following may be considered as possessing a logical and accepted approach to the problem of arrangement.

I have attempted to summarize below certain typical material and comments with respect thereto which I believe can generally be comprehended

in reports. It is not intended that the following serve as anything more than a guide in the preparation of comments, since the inclusion of all or any portion thereof is a matter that can be determined only in the light of the particular engagement and set of facts on which the accountant is to make his report. By the same token, it should be understood that the comments to be used in any particular report should in no manner be restricted to the following subjects, either as to their nature or as to the discussion relative thereto. Every engagement has its own peculiarities and problems and must be considered at all times from a purely objective viewpoint.

Operations

The transfer of emphasis in recent years from the balance sheet to the income statement has resulted, generally, in showing comments with respect to operations before those pertaining to balance sheet items.

Comments on operations usually require a deeper application on the part of the auditor than do comments on balance sheet items, but an intelligent appraisal of the salient features of the concern's operations are usually more appreciated by clients.

As a general approach to this subject, it is normally appropriate to present a summarized statement of income in comparative form showing the relationship in percentages of the various income and expense items to net sales. It may also be significant to show in some detail the composition of certain groupings and to comment on their comparative relationships and variations. Important variations between years should be explained.

The use of ratios in this section of the report, in order to emphasize certain relationships or changes from prior years is a matter that should be given thorough consideration by the report writer. Certain ratios which can be used to advantage are the accounts receivable turnover, inventory turnover (which may be shown in the inventory comments), earnings per share of common stock, net sales to property investment, proportions of net income distributed to stockholders in the form of dividends or retained in the business, and many others.

Intelligent comments concerning operations provide a fertile field for the accountant to show to good advantage the excellent services in statement analysis and interpretation that can be rendered to his client.

Financial Condition

Before commenting on the various balance sheet items, some general statements as to the over-all financial condition may be made. These comments may start out with a comparative summarized balance sheet, prepared so as to reflect the amount of working capital and current ratios, and arriving at a figure representing the stockholder's equity.

An extremely important presentation, which is being used more and more in auditors' reports, is a summary usually described as a statement of the source and application of funds. It is, in simple terms, an exposition showing the amount of money received or earned during the year and its disposition or reinvestment in the business; its importance in comment reports cannot be overemphasized.

In addition, it may be desirable to prepare an analysis in comparative form of the various elements composing current assets showing the percentage relationship of each item of the current assets to the total.

Cash

If the composition of the cash balance is not shown in the balance sheet, details thereof may be shown in the the comments. Analysis of the total may be made as to types, e.g., cash in banks, petty cash funds, and change funds, or a breakdown might be given showing the cash on deposit at various locations or by names of depositaries; petty cash funds and change funds may

be shown by location or by name of custodian.

In some instances, there may be cash representing time deposits, or cash funds may be segregated, either solely for statement purposes or by actual deposit in separate bank accounts, with respect to special property funds, sinking funds, and the like. These elements of cash would not, of course, be reflected in current assets, but it may be desirable to comment thereon under the same general caption.

Verification of petty cash funds sometimes discloses the existence of an unusually large amount of advances and unreimbursed expense vouchers which the accountant has deemed to be of sufficient importance to reclassify as such for statement purposes. Description of these items may very well be presented in the comments.

With respect to the work performed by the auditor in connection with his verification of the various elements of cash, brief statements to the effect that cash on deposit was verified by certifications obtained from the depositaries, reconcilements of bank balances were prepared or reviewed, and cash on hand was counted, should suffice.

Accounts Receivable

Classification of accounts receivable as to amounts due from customers, officers and employees, and others, where significant, is normally reflected in the balance sheet. If the classification of these items is not material for statement purposes, the pertinent details could be shown in the comments.

The confirmation of accounts receivable is considered to be a generally accepted auditing procedure, and in every instance where confirmation of the accounts receivable by direct communication with the debtors is not performed, this fact must be disclosed in the accountant's certificate, assuming that the accounts receivable in question are material in amount.

Where confirmation of accounts by direct communication with the debtors was made, the type of confirmation used, either negative or positive, or possibly a combination of both, may be mentioned. If the client is not familiar with the two types of confirmation forms, it would be appropriate to explain the points of difference.

A presentation, either in narrative or tabular form, could be given showing the extent of the auditor's confirmation test of the accounts and the extent of replies received, both as to dollar values and number of accounts. Any important exception taken by debtors in their replies should be reflected in the comments, even though the client may have been apprised thereof previously. In certain engagements, especially in bank or brokerage audits, it is necessary to include a list of accounts for which confirmation replies were not obtained.

It is usually desirable to prepare an analysis showing the age of the customer's accounts, and, since the best evidence of collectibility of an account is the subsequent receipt of the monies due, a summary incorporating both the aging of the accounts and collections thereon (usually to a date subsequent to the balance sheet but occurring during the time of examination) may be presented somewhat as follows:

Accounts collected to February 3, 1950 (as shown by the records)...
Accounts uncollected:
  Not over three months old—October to December ....
  Over three months but less than six months old—July to September ....
  Over six months but less than nine months old—January to June...
  Over one year old ....
    Total ....

The auditor may express his opinion as to the collectibility of the accounts receivable and the adequacy of the related reserve for doubtful accounts. This opinion should be based upon a review of the accounts with a responsible official, together with any other steps the auditor may take in order to assure himself that the clients' representations in this respect are well

formed and not beclouded by false optimism. It may be advisable to describe the basis on which the provision for doubtful accounts is created, such as a percentage of net sales, etc. If the reserve includes specific provision for certain doubtful accounts, it would be appropriate to indicate the amount of such accounts, and perhaps the names of the customers.

A statement to the effect that the detail accounts were found to be in agreement with the control accounts is normally not required. However, if they are not in agreement, and the difference involved is considered material, then a statement to that effect should be made.

If any accounts are hypothecated or said to be secured, in whole or in part, a brief discussion of the terms of the hypothecation agreement, description of the security held as collateral and its value, etc., may be desirable.

If, during the course of the examination, any unsatisfactory conditions relating to accounts receivable is discovered, even though it is not possible to determine the significance of the condition at the time, it should be brought to the attention of the client in the report (or by separate letter). This should be done even though the matter may have been discussed previously with the client.

Notes Receivable

The foregoing observations as to accounts receivable apply in some measure to notes receivable, with the additional factor to be mentioned that the notes were inspected. In an engagement with which I am familiar, the client requests that a detailed listing be included in the report comments, showing all notes due from employees, including date of note, employee's name, and amount.

Marketable Securities

Comments on this type of asset usually include reference to the related accrued interest account, and will generally include a statement to the effect that the securities were inspected or confirmed by the depositary or other holder. It is sometimes desirable to prepare a tabulation showing the principal amount or number of shares held, complete description of the security, book value, market value, income received during the year, and accrued interest. If it is the policy of the client to amortize bond premiums and/or discount, that factor and the basis used may be commented upon. A statement of purchases and disposals of securities during the period under review, together with any resulting profit and loss, may also be informative and desirable.

Inventories

Clear and concise comments by the auditor as to his work on inventories, and the relationship of purchasing and pricing policies to operations, can be extremely valuable to his client, and to others.

It is customary for the accountant to state what he has done to satisfy himself in his inventory verification, both as to the quantities and the pricing of the inventories. His remarks might include reference to the fact that he was present at the time physical inventories were being taken, and that he satisfied himself with respect to the quantity features of the inventory by observing the counting procedures followed by the company's employees and making test counts of quantities himself, and that tests of prices and extensions were made to the extent that he could rely on the inventory pricing as a whole.

Classification of inventories in addition to that shown in the balance sheet may be appropriate, especially where it is desired to comment further upon costs, turnovers, "loss-leaders", and the like. Where the client's organization consists of several branch houses, classification of inventory as to location may be made.

As previously mentioned, account-

ants are exceptionally well qualified to analyze financial reports and statements, and to evaluate the significance of facts discovered by them during the course of their examination. In the matter of inventories, this factor is especially true. Imagination and initiative on the part of the auditor in the verification of inventories, and inquiry into the relationships of gross profit margins by type of product, by location, or by many other ways, may disclose conditions which might result in eventual hardship or financial embarrassment to the client, if they be allowed to continue. The accountant can perform immeasurable service to his client in this respect if his studies, for example, indicate that inventory turnover of a certain product had decreased to a point where either additional sales promotion was necessary, or the product should be discontinued in a particular location or even on a company-wide basis. Any matters of a similar nature which come to the attention of the accountant during the audit may well be commented upon in the text of his report.

Where a change in policy relating to inventory practices has been effected during the period under review, and the effect upon operations and the comparative financial position of the client is significant so that reference thereto has to be incorporated in the accountant's certificate and suitable footnotes appended to the financial statements, additional elaboration thereon would be most appropriate in the comments.

Property and Related Reserves for Depreciation

Where classification of property accounts is not shown in great detail in the balance sheet, such details may be shown in the comments. In certain cases where there are a considerable number of property classifications they may be shown in a separate schedule and possibly summarized in the comments.

Information with respect to the changes in the property and reserve accounts during the period under review is normally welcomed by clients. If the volume of such changes is considerable, it is well to present such information in the form of a summary, or else they may be commented upon in narrative form. This presentation may be supplemented by showing the major property additions during the year by type and location.

It is sometimes desirable to prepare a summary showing the gross book value of various classifications of property and the related reserves for depreciation and to include therein the depreciation rates and the percentage relationship of the reserve to the related asset.

Where distribution of the annual depreciation provision is made to a number of accounts or departmental operations, a summary setting forth such data may be quite informative, especially where comparative figures for, say, the last two or three years are also shown.

The public accountant is not an appraiser or an engineer; however, he does have a responsibility in determining that the depreciation provisions are at least reasonable within a broad range and have been computed on an accepted basis. If the accountant finds that the basis used, or the rates employed, are such that they appear to be completely out of line or irregular, whether deficient or excessive, the accountant should request that proper adjustment be made, and if adjustment is not made he must qualify his certificate accordingly and comment fully thereon in his report. Similarly, if the client has made changes in rates, or has revised the estimated remaining life of the properties, this fact should be mentioned in the comments, even though the effect may not be of sufficient importance to require reference in the accountant's certificate.

Deferred Charges

Deferred charges are generally not shown in any great detail in the balance sheet, and a summary of the items contained therein together with brief mention as to their verification, reason for deferment, and basis of amortization should be shown in the comments.

It is appropriate to present at this point the amount of insurance coverage carried by the client, and to comment on any deficiency or excess in relation to current replacement values which may be noted by the auditor. With respect to the amount of insurance carried on inventories, property, etc., it would be appropriate to make reference thereto in the comments pertaining to those assets.

Other Assets

The following discussion deals not only with those items which may be classified specifically in the balance sheet under this caption, but refers to assets which, by their nature, do not fall into any of the classes thus far mentioned. For example, there may be investments and advances to affiliated companies, special property funds consisting of cash and/or securities, real estate mortgages, and other accounts, which because of their significance and nature have been classified separately. Whatever their nature or amount, they may be worthy of intelligent comment with respect to audit procedures undertaken, disclosure of details of the balances, or transactions that may have occurred during the year.

Accounts Payable and Accrued Accounts

A summary of the amounts composing the respective balance sheet figures and further detailed classification thereof, together with a brief observation with respect to their verification is usually desirable.

Federal Income Taxes

The importance of federal income taxes on the operation of present day business cannot be overemphasized. Reference could be made to any unusual factors involved in the composition of the accrual or in the determination of the provision for the current year, the status of prior years' taxes as to the years which have not yet been examined by the Bureau of Internal Revenue, existence of proposed deficiency assessments and the stand the Company intends to take as to acceptance of the agent's findings, status of claims for refund, and other matters of similar importance.

Mortgages Payable

Additional explanatory detail with respect to this account could consist of a brief discussion on the origin of the mortgages, location of the related properties, names and addresses of mortgagees, and a statement could be made to the effect that the mortgages were verified by means of confirmations obtained from the respective mortgagees.

Capital Stock

Comments with respect to capital stock might contain reference to the manner of verifying the number of outstanding shares, and mention could be made of any changes that may have occurred during the period in connection with new issues, purchase or sale of treasury stock, increases or decreases in the number of authorized shares, options granted, etc.

Surplus

Generally, the details of earned surplus will be shown in a separate exhibit or appended to the statement of income. If there are other forms of surplus, such as capital or paid-in surplus, full comment with respect to their origin and the changes that have taken place during the year should be made, whenever details of such changes are not shown in the balance sheet, or in separate schedules.

General

Some accountants prefer to include an appendix in their report. When an

appendix is used, it may include additional statistical tables, graphs, etc., not shown in the body of the comments, and present, in summary form, the verification procedures followed in connection with those accounts discussed in the comments, and possibly others where no comments were presented. The philosophy of summarizing the various auditing procedures at this point in the report, rather than including them in the comments, is based on the theory that the normal reader may become confused in reading comments if they are interwoven with descriptions of the auditing steps followed in each case. I believe that, in some cases, it is quite impossible to disassociate general comments from those concerned with audit procedures, such as a discussion relating to the confirmation of receivables. My own feeling in the matter is that unless there be compelling reasons otherwise, such as the requests of the client, any references to verification procedures should be made part of the comment section itself.

In lieu of presenting certain detailed tabulations in the comments, it is sometimes advisable to present the information in the form of a schedule to the financial exhibits. Where this is done, appropriate reference should be made to the schedule both within the exhibit and in the body of the respective comments.

Where the accountant deems it necessary to make recommendations or suggestions as the result of his audit, they may be presented in the respective comments, or in a separate letter report. If the recommendations have been, or are to be, made the subject of a special report, it may be appropriate to make reference thereto in the comments of the regular report.

In concluding my remarks I can only say that the subject under consideration has so many ramifications that it provides an almost inexhaustible field for discussion. Practical limitations have necessitated that my remarks be restricted to an attempt to highlight the elements of but one phase of this subject.

There is, to my mind at least, no basic difference in the approach to the matter of form of report that would serve to distinguish the efforts and services of, or the problems confronting, the small or medium-sized practitioner from those of the larger accounting firms. It is simply a question of rendering the most valuable service possible to our clients.

AN ADIRONDACK VIEW

When CPAs Meet these days it's a good bet that their conversation is not entirely shop talk. It is more apt to be Korea, our boys, Red China, etc. Wish we knew the answers, or could figure them out on a calculator; or find them in a rapid income tax finder; or get them on a 96 column work sheet that has to use the office floor for a desk.

From the mountains two things look clear:

1. We of the U.S.A. seem to assume that problems get solved by throwing a bunch of money somewhere, or inventing a new machine, or building a new building. It will take more than a tall, thin skyscraper, shaped like a pad of working paper, stood on its end, to make the United Nations succeed.
2. A successful H-bomb will not bring peace. We got the atom bomb; but where is the peace? Bombs may win wars but they don't win a peace.

If we applied the accounting approach, we would first try to get all the facts. Is it too little rice in Asia, or too many people, or too much communism, or bad religion, or ignorance, or ill health, or no television, or our lack of "understanding", or what? In applied psychology and sociology we seem to get licked all the time. Perhaps we better cut back and ration our technological output and push up our social science production—find out how to influence people and make friends on an international basis.

LEONARD HOUGHTON, CPA
Of the Adirondack "Chapter"

Modern Developments in Financial Statements

By Sidney G. Winter, C.P.A.

The subject of modern developments in financial statements is one seemingly open to a variety of treatments. It is marked by certain rather obvious hazards: disagreement as to the period to be regarded as *modern;* an adequate definition of the word *developments;* and differences of opinion as to what may be covered by the term, *financial statements.* In many ways, it would be simpler if one refrained from making appearances such as this—it would save him from the risk of describing as "modern" items which some of you may justly regard as "pretty old", there would be no need to determine the number of instances constituting a "development", and it would be unnecessary to describe precisely what is covered by the expression "financial statements."

While some definition of terms may be regarded as essential to constructive discussion, the time to be devoted to the framing of definitions may be held to a minimum. It may be well-nigh eliminated, in this present case, by a slight modification of the subject of my remarks—a modification designed to permit, within the limits of generally accepted practice, each listener to supply his own definitions. This, I believe, is preferable to a procedure frequently encountered—that of the speaker's ignoring completely the subject assigned to him. Accordingly, the subject is rephrased to read "Some Remarks on What Might Be Classed as Modern Developments in Those Exhibits Rather Frequently Termed Financial Statements." One of our hosts informed me that I should feel completely free to amplify or limit the subject. I trust it will not be claimed that I have taken undue liberties.

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Mr. Winter has been Professor and Head of the Department of Accounting, College of Commerce, University of Iowa since 1926, and became Dean on July 1, 1950. He is the author of C.P.A. Review, a two-volume text.

This paper was presented by Dean Winter at the Twenty-Fifth Annual Michigan Accounting Conference held at Ann Arbor, Michigan, on October 14, 1950.

As we have all observed, the annual report to stockholders, during recent years, has tended to become "a thing of beauty" if not always "a joy forever." In content and format it is limited, if at all, chiefly by the imaginative powers of those charged with its preparation. Charts, graphs, pictures, cartoons, maps, and other devices have been used to dress up and make attractive these reports which were long limited to cold figures accompanied by an equally cold and seemingly impersonal letter from the president. The generous—even abundant—use of color has added eye appeal. One still finds reports limited to the combination of figures and letters, but, even in these, there is frequently evidence of an effort to achieve presentations which through format and typography convey an impression of dignity and good taste. Between the report "in technicolor" and the report restricted to the "cold figures" (often unappetizing even to the expert) lie countless variations of the pattern.

All of us are aware of the sharp dif-

ferences of opinion as to the worth of some of the techniques used in annual reports. Unfortunately, I was not privileged to attend the Annual Reports Forum held here last month, but I have read the remarks presented on that occasion by Chairman McDonald of the Securities and Exchange Commission. Many of you will no doubt recall his reference to those who are wont to treat facetiously the "gorgeous technicolor" of some of these "travelogues." I would like to endorse the Commissioner's statement that, "while some reports do seem unnecessarily elaborate, management's efforts to make the annual report interesting and readable are to be commended." It seems a safe conclusion that the layman is more likely to read financial statements when they are presented as part of an attractive and informative report.

Perhaps we should agree here that the expression "financial statements" connotes, as a minimum, the balance sheet, the income account, and a reconciliation of surplus balances at the beginning and end of the year. It seems likely that our primary interest lies in published statements. Usually we have in mind certified statements which are available, in one way or another, to the public.

A discussion of financial statements cannot reasonably disregard the environment in which the statements are found. It is for this reason that I have commented on, and will again refer to, published annual reports. I do not wish at the moment to enter a controversy as to whether financial statements are more or less effective alone or associated with other statistical devices, maps, pictures, or cartoons. Some contend that the statements are amplified and made understandable by the use of these devices. Others appear equally positive that the statements are ignored while the reader finds entertainment and misinformation in attractively presented distractions.

Of one thing I am confident. It is that the accountant must be aware of the environment in which his statements are found. He must realize that even statements of good character may jeopardize their reputations if found consorting with an underworld of shady graphs, crooked charts, distorted maps, and other devices of low estate. It may be well beyond the role of the professional accountant to censor the contents of his clients' reports, but he should be alert in resisting any presentation which departs seriously from the high ethical principles governing his own work. If one would compare graphically, on a given page or facing pages, data appearing in the accountant's comparative report, it would appear essential that a single scale be used.

It is my opinion that in many annual reports there has been a sincere effort to portray for the layman in a nontechnical way the essential details carried in the financial statements. One need not agree that emphasis has always been properly placed. Undoubtedly one could find examples in which there would be rather general agreement that a startling presentation of certain data may have drawn the reader's attention away from equally important but less favorable data carried in the statements alone. That graphic presentation throughout the body of the annual report often leaves something to be desired is a characteristic shared by the financial statements themselves.

The goal of financial statement and annual report preparation may be summed up in the word, adequacy. Adequacy is to be considered both quantitatively and qualitatively thereby assuring oft-mentioned *adequate disclosure.* There is continuing evidence that progress toward the attaining of this goal is being made. I do not overlook encounters with those statements which prompt the conclusion that the accountants or the management, or both, remain ignorant of, or unimpressed by, important trends of the past ten or fifteen years. We must not overlook the fact that the educational

process moves slowly, very slowly. Patience is probably a greater virtue than is the crusading spirit.

One of the major developments in accounting statements is the providing of *more* information. It is rather common to present a relatively detailed explanation of the principles followed in consolidating accounts. Investments in foreign subsidiaries may have, as in the reports of the National Dairy Products Corporation, Quaker Oats Company, United States Rubber Company, United Fruit Company, and others, an adequate breakdown showing separately-owned companies in the United States, in Canada, in England, in continental Europe or such other detail as might be of value to the reader. One finds wholly-owned companies segregated from partially-owned companies, sometimes with a specific reference to the percentage of ownership in each case.

It is common for the accountant's certificate to contain a reference to the notes, or footnotes, or comments accompanying the certified statements. The reader is repeatedly warned that the statements should be read in conjunction with the notes or comments. There can be little excuse for the reader's missing these notes, but there are still instances in which he may be excused for missing their meaning or significance. I hope I am right in the opinion that these comments are generally better prepared and more informative than was the case not many years ago. An interesting example of this tendency toward amplification of footnotes and of the accountant's awareness of the significance of non-accounting portrayals is found in the 1949 report of the United States Rubber Company where the certificate states that "the accompanying consolidated balance sheet and statements of consolidated income, consolidated earned surplus, and consolidated capital surplus, with the financial review, present fairly . . . etc." This financial review is a series of comments and analyses covering:

1. Basis of consolidation for the parent and 17 subsidiaries, all but two being wholly owned, three being in Canada and six in other foreign countries. A small Canadian subsidiary was sold during 1949 and a dormant British selling company was liquidated.
2. Foreign assets. The basis for handling and pertinent comment on results of policies followed.
3. Financial. A statement of funds provided and applied.
4. Inventories. At "cost or market" with reserves for intercompany profits in all instances, and with cost of goods sold on an average cost basis.

Without further description, let me enumerate the remaining headings in the financial review:

5. Properties, plant, and equipment.
6. Debentures and serial bank notes.
7. General reserves, with an analysis of the decrease in 1949.
8. Parent company income and earned surplus.
9. Employee data.
10. Litigation, a reference to the remarks of the president elsewhere in the report.

In preparing this paper, there has been no exhaustive research to determine how many do this and how many do that. Such a counting of noses may have some merit but, at best, it points up only what is being done at the moment. In running through some hundred and fifty reports, I have tried to pick up certain things indicative of progress as I view it. Obviously I could not overlook other things which, in my mind, leave room for marked improvement. Chiefly I would ask you to consider these things—not to agree necessarily with my evaluation of them. The citing of specific reports is not to be construed as my believing that such cases are unique.

Two concepts appear to be gaining wide acceptance. One repeatedly finds treasury shares expressed as an unallocated capital deduction carried at cost. I have long been on record as in favor of this practice and I have yet to hear arguments which to me warrant a change in my position.

Then there is the matter of the "clean surplus account." I still believe that all expirations of assets should appear in the income account for the pe-

riod in which the expiration occurs or, if later discovered, for the period in which it is given accounting recognition. A feeling of shock is not to be avoided when I find, as in the Quaker Oats statements for the year ended June 30, 1950, a reported net income of just over ten million dollars accompanied by a surplus debit amortizing trade-marks, trade rights, and goodwill in the amount of $10,145,000.

There has been improvement in the matter of presenting comparative statements. Almost uniformly, amounts are presented for the current year and for the immediately preceding year. In some reports only comparative balance sheets, income accounts, and surplus analyses appear, no separate statements being shown for the year under review.

A few reports show comparisons for twenty-five years, some from the inception of the company, many for ten years. There may be some utility in comparative statements for twenty-five years or more but it seems that the ten-year portrayal should be adequate in meeting the needs of the vast majority of readers.

There has been experimentation with new titles. Balance sheet data may appear as "Our Financial Position." The income account is "Income and Expense and Earnings Retained for Use in the Business." Many balance sheets emphasize "Earnings Retained in the Business", with or without the word *Surplus* shown parenthetically. In many statements one finds attempts to explain and present in a non-technical way the usual balance sheet and income account subdivisions.

More striking than the changes in titles are the cases in which there has been a sharp departure from the conventional statement forms. In my early experience as a student of accounting there were many occasions on which the relative merits of the "account form" and the "report form" for both balance sheet and income account were debated. We may not have reached a proper decision as to merit, but we did reach the inevitable conclusion that practitioners favored the "account form" for the balance sheet and the "report form" for the income account. Currently, there appears to be little departure from the report form in portraying income and expense summaries, but there are increasingly numerous examples of the report form's being used for balance sheet data. These may follow the old pattern in which the total of liabilities is deducted from the total of assets to determine the capital:

Current assets	$ 7,000	
Plant (net)	10,000	$17,000
Current liabilities	$ 3,500	
Debt	4,000	7,500
Capital:		
Capital stock	$ 5,000	
Surplus	4,500	$ 9,500

As an alternative, the presentation may be:

Plant (net)	$10,000	
Less funded debt	4,000	
Equity in plant		$ 6,000
Current assets	$ 7,000	
Less current liabilities	3,500	
Working capital		3,500
Net equity of owners		$ 9,500
Represented by:		
Contributed for shares	$ 5,000	
Earnings retained for use in business	4,500	
	$ 9,500	

A third arrangement has appeared:

Plant (net)		$10,000
Capital contributed by owners	$ 5,000	
Borrowed from bondholders	4,000	9,000
		$ 1,000
Current assets	$ 7,000	
Current liabilities	3,500	
Working capital		3,500
Earnings left in the business		$ 4,500

A fourth grouping is illustrated in the Weyerhaeuser Timber Company's 1949 report. This may be summarized (000 omitted):

Current assets	$64,230	
Current liabilities	16,464	
Working capital		$ 47,766
Other assets (net)		184,030
Total assets before debt and minority interest		$231,796
Debt	$ 2,700	
Equity of minority	4,249	6,949
Total net assets		$224,847
Stockholder's interest represented by:		
Capital stock	$99,287	
Appraisal increase	32,111	
Earned surplus	93,449	
		$224,847

It should be understood that this summary is used to illustrate the general arrangement of asset, liability, and capital items and that it makes no attempt to reproduce the details presented in the company's statement of consolidated financial condition.

It is obvious after only limited inspection of some of these presentations that the arrangement may have unhappy consequences if one or another of the reported items changes significantly in relation to certain other items. "Net plant" may frequently be less than the total of long-term debt and capital stock. It may be less than either of these alone. The resulting "red figures" may produce confusion in the mind of the reader. A second hazard should not be overlooked—that of being unable to present comparative statements in the given pattern from year to year with essential clarity.

I would by no means suggest that we should become and remain strictly orthodox. Progress comes chiefly through experimentation, the old process of trial and error. Both the accountant and management are to be commended for any honest attempt to improve financial and related statements through which the results of stewardship are reported to the several parties at interest.

There is little need to prolong these remarks—perhaps, already, they have been unduly long. We can pass over such things as improved schedules of investments held for other than purposes of control, schedules of capital growth, analyses of employment costs and similar items. We should not overlook something of an innovation which may become an important adjunct of financial statements. It is a summary of Resources Committed for Next Fiscal Year. Such a summary accompanies, for example, the June 30, 1950, statements of Meridith Publishing Company and should prove valuable to stockholders and creditors particularly.

I might be held remiss in discharging my obligation here—and rather certainly a changed person to some of my friends—if I closed this paper without mentioning some of the things I

do not like. I shall attempt to be both brief and temperate, and cite only a half dozen items.

1. There is no place in financial statements for essentially meaningless comments such as

   "Property, Plant, and Equipment (stated at cost or, as to certain properties, at sound values as of dates of acquisition, less certain adjustments)."

2. I object to a certificate's comment on the adequacy of depreciation provisions when the reader is advised that "No comment on the adequacy of depreciation reserves is made on the ground that the accountants are not technically qualified to offer such comments." As I see it, the accountant could and should do more. As a minimum he could recite the principles or procedures followed by the client and comment on their degree of conformity with those generally obtaining among comparable concerns.

3. The following leaves something to be desired: ". . . the company elected to adopt the LIFO method of valuing its green coffee inventory. This election enabled us to reduce the carrying value of this commodity to a figure substantially below present market value, and also reduces our Federal Income Tax payments for the year." The comments then go on to relate that the inventory was reduced by some $700,000 and income by some $300,000. It is assumed, I take it, that the books are still in balance and that something was done with the $400,000 not mentioned.

4. One of the major deficiencies in financial statements is their failure to provide analyses of changes in reserves, particularly those reserves shown in the liability section or the capital section of the balance sheet.

5. It is unfortunate that balance sheets continue to contain a reserve section into which there are dumped and totalled wholly unlike credits representing amortization of assets, estimated liabilities, and earmarked capital.

6. There are still instances in which items normally classed as debits (credits) appear as negative amounts among the credits (debits) even though the following of the normal procedure poses no problem. For example, in a recent comparative income statement of American Bus Lines, there appears in each of the two years among the expenses a negative figure representing profit on sale of equipment. An adequate reason for such procedure has not come to mind.

The educational process is a slow one, whether inside or outside of the educational institution. That a certain practice prevails is not proof that it is satisfactory, in step with changing times, or representative of our best efforts. Progress is marked by departures from the orthodox or established pattern. We should take every precaution that our departures do not become ill-considered excursions necessitating too frequent strategic retreats.

There is for all of us a neat problem of timing in the discarding of the old and the adopting of the new. If we jump too soon, we are not only embarrassed by the need for frequent retreats, but we are regarded by our more cautious friends as dangerously unstable. Waiting too long, we lose the value which once attended our conservative position and find ourselves classed among the out-of-date reactionaries.

Of another thing I am confident. It has been a happy experience over the years to have even a very small part in working with some of those teachers and practitioners of accounting who have originated and advocated changes looking toward the improving of financial statements.

Cost Accounting for Ice Cream Companies

By Alexander W. MacDougall

In general, the majority of the ice cream manufacturing plants are departments of a combination dairy plant that produces milk, cream, butter, cottage cheese and other dairy products, as well as ice cream. About 20% of the plants manufacture ice cream only, and these plants usually have a sales department that sell soda fountain equipment and dealers' supplies.

This article covers the accounting for ice cream operations, only. However, when we speak of an ice cream plant, it could very well be the ice cream department of a combination dairy.

Most ice cream plants are separated into cost centers or departments. The usual indirect or service departments are: Delivery, Sales, Garage, Electric Cabinets, Power and Refrigeration, and Administrative and General, with Advertising as a sub-department under Sales. The direct or productive departments are Mix, Freezing, Packaging, Storage and Laboratory.

The nature of the product leads to a production order system of accounting and control being used. There is practically no work-in-process inventory, as all mix produced in one day is usually made into ice cream the day it is produced. Therefore, the inventories consist of raw materials and finished goods.

The basic cost information orginates on work papers and special forms. Most of these are originated by other departments and the accounting department summarizes, prices and extends the forms as they are received from the other departments.

Usually a standard purchase requisition, purchase order, and receiving system is used. Our material costs are determined by the use of two special forms or reports. The first is a Daily Mix Batch Report (see sample on page 108). This form has space for listing all the ingredients used in making a mix, such as cream, milk, sugar, flavors, fruits, stabilizers, etc. One of these reports is prepared by the production department for each mix that is to be made. It serves as a production order and, after the mix is made, it serves as a production report. The mix batch reports for each day's production are forwarded daily to the accounting department. They are summarized at the end of the month, a summary being made for each kind of mix made during the month. The average unit cost for each material is entered and extended. This gives us the material cost for each type of mix for the month.

The second form or report the accounting department receives from the production department is the Ice Cream Freezing Report (see sample on page 107). This report has space for listing the quantity and type of mix, the fruits, nuts, candy and other material used. It also serves as a production order to the freezing and filling department. This department fills in the quantity of mix, materials, etc., used and the quantity of finished product produced and sent to the storage or hardening room. In the case of transfers from one kind of product to another this report is used.

Alexander W. MacDougall is the Secretary and Comptroller of the Union Ice Cream Company, Nashville, Tennessee. He was formerly connected with Consolidated Vultee Aircraft Corporation at their Miami and Nashville plants, and also has had wide experience in the hotel and restaurant field.

This paper was presented by Mr. MacDougall at a recent meeting of the Nashville Chapter of the National Association of Cost Accountants.

These reports are received daily and are summarized at the month-end by flavor and size of package. The average unit cost of the materials, including the mix cost, is entered and the amounts are extended and totaled, giving us the material cost by flavor and package size for all products produced.

The use of receiving records and daily inventories of mix and cream in connection with these two reports referred to above enables the accounting department to keep a daily record of butter fat gain or loss. As butter fat is one of the major items in manufacturing ice cream that is subject to loss, a daily record of butter fat gain or loss is of vital necessity to management in controlling material costs. The butter fat gain or loss is determined in the following manner: The opening inventory is added to the day's receipts to give us the total amount of butter fat in raw materials to be accounted for. The amount of butter fat in the closing inventory plus the amount used gives us the amount of butter fat in raw materials accounted for. The difference in the two totals is the gain or loss of butter fat in handling raw materials. The butter fat used from above plus the butter fat in the opening mix inventory gives us the butter fat in mix to be accounted for. The butter fat in mix used plus butter fat in the closing mix inventory gives us the amount of butter fat in mix accounted for. The difference is the gain or loss of butter fat in mix making. The butter fat in mix used from above compared with the butter fat in the products produced gives us the butter fat gained or lost in ice cream making. The total of the above three gains or losses gives us the total butter fat gain or loss for each day. This total is accumulated for each month.

The same kind of records are kept on solids not fat (S. N. F.).

The plant production department provides the accounting department with a daily report of hours worked on each item produced that day by flavors and size of package. This report when summarized at the month-end gives us a basis for the proration of labor and expense in the production departments.

Transfers to and from are shown on the freezer room reports and the totals for the month are taken from the summaries. An example of a transfer is when slabs of ice cream, called pans, are taken out of storage and cut into bricks or sliced and made into ice cream sandwiches. This would, of course, be a transfer from pans to brick or sandwiches.

Manufacturing gains or losses are also determined from the summaries of the freezer room reports. An example of a loss is the loss sustained when a pan is sliced into brick and then sliced into six or eight slices per quart. There is a loss in this operation where the blades cut.

In some cases items manufactured by other ice cream plants are purchased. These are reported by the accounts payable department. The reason for outside purchase is a dealer demand for an item, usually a novelty, that is not great enough to warrant production by our plant but still large enough that it can not be ignored. Or, ice cream plants that serve two or more states or sections of states may find the laws of the state in which they do only a little business will not allow an ice milk bar to be sold. As most of their business is in the state that allows ice milk bars they produce such a bar for the dealers in that state but it is more economical to buy an ice cream bar than to manufacture it in their own plant for the dealers in the other state.

The production department, under the supervision of the accounting department, takes a physical inventory of the storage or hardening room on the close of business on last day of each month. This inventory is priced at the cost to manufacture of the preceding month.

Dump, Gratis and Laboratory Test ice cream is determined from sales slips and requisitions on the storage room.

All of the foregoing information is

brought together in the accounting department and used in compiling the monthly Cost Report-Manufactured Products (see sample on page 109). One of these reports is made for bulk, one for package, and one for novelties and specialties. An examination of the sample discloses that the report has one major column that is divided into four sub-columns. On the Cost Report for Bulk we use four major columns: one for total, one for standard bulk, one for sherbet and one for standard pans. The sub-columns are used for gallons or pounds, pounds of butter fat, a per unit column, and an amount column. In the case of novelties and specialties we may use as many as ten or more major columns.

Lines 1 through 11 are used to record the various types of mix used. Lines 14 through 20 are used to list the Transfers From. Lines 21 through 30 are used to list other materials such as Fruits, Flavoring, Coloring, Sandwich Cakes, Cones, etc. Line 31 is used to record Manufacturing Gains or (Losses). Line 33 is used to record Total Material Cost per gallon. Line 35 is used to record Labor and Expense. Line 37 is used to record Total Cost to Manufacture. Line 39 is used to record Outside Purchases of Finished Products. Line 41 is used to record the sub-total. Line 43 is used to record the Opening Inventory. Line 45 is used for the sub-total. Line 47 is used to record the Closing Inventory. Line 49 records the Balance to Account For. Lines 51 through 60 are used to record Transfers To. Line 61 is used to record Inventory (Gains) Losses. Line 63 is used for a total of lines 51 through 62. Line 65 is used for Total Cost of Sales.

This form is used in the following manner. Mix used plus Transfers From plus Other Materials plus or minus Manufacturing Gains or (Losses) give Total Material Cost. Total Material Cost plus Labor and Expense give Total Cost to Manufacture. Total Cost to Manufacture plus Outside Purchases, plus Opening Finished Goods Inventory less Closing Finished Goods Inventory gives Balance to Account For. The Transfers To plus or minus the Inventory (Gains) or Losses subtracted from the Balance to Account For give Total Cost of Sales.

In using this form there are a few peculiarities to be noted. The opening inventory is priced at the second previous month's Cost to Manufacture.* Transfers To, Gratis, and Closing Inventory are priced at the previous month's Cost to Manufacture. The discards, dump and inventory gain or loss ice cream quantities are not extended, thereby reducing the number of gallons and thus increasing the unit cost of sales.

The other major cost report issued by our accounting department is the operating report. This report is issued monthly and year to date, and compares present period operations with corresponding period year ago. No special reports are received from other departments, all information needed is developed in the accounting department.

The information developed is as follows: Gross Sales, Discounts and Allowances, Net Sales, Cost of Products, Container Expense, Gross Profit, Delivery Expense, Selling Expense, Administrative Expense and Operating Profit. A great many operating statistics are also presented by this report, some of which are as follows: Net Sales, Gross Profit and Operating Profit on a year to date basis; Sales statistics for Bulk, Package, Novelties and Total, for month and year to date; number of routes operated; number of customers served and average gallons per customer; other statistics, such as % of Butter Fat, % Overrun obtained, Customers gained and lost, Advertising expense for month and year to date, Cabinet expense for month and year to date, Truck cost per day operated, Payroll statistics per department with a

* This is because when it was priced as the closing inventory of the previous month, that month's current cost to manufacture had not yet been computed.

breakdown of regular and overtime. This form also carries a comment section for explanation of any unusual items.

One of these reports is prepared for each branch and for the main plant, and one for the combined operation. Major columns are used as follows: one for total, one for city routes, one for country routes, one for shipping, one for dealers' supplies, and one for army contracts. The reason for separating army contracts is that such sales are considered as plus sales.

Our management uses the operating reports to check on each branch and the various departments. Each branch manager is given a copy of the operating report for his branch. We also make some graphs from the figures presented on the operating reports and furnish department heads with copies of the graphs that reflect operation of their departments.

ICE CREAM FREEZING REPORT

Type of Mix

Mix Material	Flavors Used	Unit Cost	Amount	Quantity
1	Vanilla (Liq) Ozs			
2	Pecans Lbs			
3	Butterscotch Lbs			
4	Caramel Color Ozs			
5	Chip Choc Candy			
6	Fudge Syrup Lbs			
7	Maple Flavor Gal			
8	Marshmallow Lbs			
9	Orange Juice Gal			
10	Peaches Lbs			
11	Peppermit Candy			
12	Pineapple Lbs			
13	Raspberries Lbs			
14	Strawberries Lbs			
15	Coloring Ozs			
16	Choc. Coating Lbs			
17	E.D.M. Fudge Lbs			
18	Nut Syrup Lbs			
19				
20				
21				
22				
23				
24				
25				
26	Total Fruits, etc			
27	Vanilla Mix Gal			
28	Fruit Mix "			
29	Chocolate Mix "			
30	Sherbet Mix "			
31	Ice Milk Mix "			
32	Popsicle Mix "			
33	Fudgsicle Mix "			
34				
35	TOTAL			

ICE CREAM FILLING AND PACKAGING REPORT

Transferred from:	Size	Hardening Room Count	Gallons
To Flavor:		**Dozens Produced**	**Gallons Produced**
	2½ Gals.		
	5 Gals.		
	Quarts		
	Pints		
	2 Gal. Pans		
	Dozens		
	Cartons		
Total Mix	Total Ice Cream		
Add F. & F.	Less F. & F.		
	TOTAL		
Overrun			

APPROVED:

DAILY MIX BATCH REPORT

Mix Made ______________________________

Date ______________________________

Pounds	Gallons	% Fat	INGREDIENTS USED	Pounds S.N.F.	% S.N.F.	Pounds Fat	UNIT	AMOUNT
			Sweet Cream					
			Sweet Cream					
			Sweet Cream					
			Sweet Butter					
			Skim Cond. Plain					
			Skim Cond. Sweet					
			Skim Milk Powder					
			Pectin					
			Gelatin					
			Krabyn					
			Dariloid					
			Fudg-in-Powder					
			Citric Acid					
			Corn Sugar					
			Cane Sugar					
			Frodex					
			Color					
			Popsicle Units					
			Fudgicle Units					
			Choc. Liquor					
			Cocoa					
			Vanilla Extract					
			Strawberries					
			Plums					
			Peaches					
			Raspberries					
			Pineapple					
			Laktone					
			Rerun					
			Water					
			Mix—Plain					
			Total to Account for					
			Loss in Production					
			Gain in Production					
			Mix Produced					
			Total Butterfat Used					
			Total Material Cost					
			Labor and Expense					
			Total Cost to Manufacture					
			Opening Inventory					
			Closing Inventory					
			Balance to Account For					
			Transfers To:					

	% Sugar	% Milk Fat	% Milk S.N.F.	% Total Solids
	% Gelation	% Other Fat	% Other Solids	% Chocolate

		GAL. LBS.	LBS. B.F.	PER UNIT	AMOUNT	GAL. LBS.	LBS. B.F.	PER UNIT	AMOUNT	GAL. LBS.	LBS. B.F.	PER UNIT	AMOUNT	GAL. LBS.	LBS. B.F.	PER UNIT	AMOUNT	
1	MATERIALS USED:																	1
2																		2
3																		3
4																		4
5																		5
6																		6
7																		7
8																		8
9																		9
10																		10
11																		11
12	TOTAL USED—GALLONS																	12
13	—BUTTERFAT																	13
14	TRANSFERS FROM:																	14
15																		15
16																		16
17																		17
18																		18
19																		19
20																		20
21	OTHER MATERIALS:																	21
22																		22
23																		23
24																		24
25																		25
26																		26
27																		27
28																		28
29																		29
30																		30
31	MANUFACTURING GAINS (LOSSES)																	31
32																		32
33	TOTAL MATERIAL COST																	33
34																		34
35	LABOR AND EXPENSE																	35
36																		36
37	TOTAL COST TO MANUFACTURE																	37
38																		38
39	OUTSIDE PURCHASES—FINISHED PRODUCT																	39
40																		40
41	TOTAL																	41
42																		42
43	OPENING INVENTORY																	43
44																		44
45	TOTAL																	45
46																		46
47	CLOSING INVENTORY																	47
48																		48
49	BALANCE TO ACCOUNT FOR																	49
50																		50
51	TRANSFERS TO:																	51
52																		52
53																		53
54																		54
55																		55
56																		56
57																		57
58																		58
59																		59
60																		60
61	INVENTORY (GAINS) LOSSES																	61
62																		62
63	TOTAL																	63
64																		64
65	TOTAL COST OF SALES																	65

____________________ (NAME OF COMPANY) MONTH OF _____________ 19___

____________________ (CITY AND STATE)

COST REPORT—MANUFACTURED PRODUCTS SCHEDULE No. ______

Accounting and Auditing Aspects of a Moving Picture Theatre Chain

By Eric W. Walley, C.P.A.

A great deal could be written on the subject of accounting and auditing aspects of a moving picture theatre chain. However, an article of this type will permit only a brief discussion of such a broad subject and the following comments will therefore be confined to those matters which appear of the greatest interest and importance to the accountant and auditor. Accounting records and procedures as well as auditing practices of the industry typical of those found in other businesses will not be dealt with. Although it is very tempting to broach the many interesting operating, financial, and other problems of the chain exhibitor, these matters must be omitted for the sake of brevity.

Eric W. Walley, C.P.A., is a member of the Society and the American Institute of Accountants. He is a graduate of the School of Commerce, Accounts and Finance of New York University and for a number of years was associated with the accounting firm of Price, Waterhouse & Co. He is presently connected with the production-distributing activities of Radio-Keith-Orpheum Corporation.

During World War II, Mr. Walley was on active duty with the Special Services Division of the Army Service Forces. During the first two years of the war he was instrumental in placing the post exchange operation of the Panama Canal Department on a chain-store basis and later served at the Division's headquarters in Washington and New York. Here his duties pertained primarily to the financial and accounting aspects of the world-wide exchange operation, motion picture service, and other welfare activities of the Army.

Transactions Relating Mainly to Chain Exhibition

Before delving into the debit and credit phases of the subject, let us review briefly a few of the more important transactions relating mainly to chain exhibition. Like those of any chain organization, the records and accounting procedures of the movie chain must furnish the home office management with up-to-the-minute operational results and at the same time safeguard the assets of the enterprise.

Movie exhibition is primarily a cash business and the admission ticket is the principal item sold. A second very important source of revenue in theatres is from the sale of popcorn, candy, and numerous other items displayed on stands or in vending machines. These activities may be operated by the exhibitor or by concessionaires. Most chain exhibitors operate both leased and owned theatres. Theatre buildings owned in fee often contain, in addition to the theatre itself, stores, offices, apartments, etc., which produce considerable revenue in the form of rents.

The major expense of the exhibitor is apt to be the cost of film service. This expense includes the license fees or rentals paid film distributors for the privilege of showing feature photoplays (usually any motion picture, regardless of topic, of 4,000 feet or over in length), short subjects, and newsreels. Feature productions are usually licensed on a percentage of gross receipts basis or on a flat rental basis, that is, a fixed price for a certain number of exhibitions. Certain variations of the percentage method may involve graduated percentages or guarantees of return for the

exhibitor or the distributor. Short subjects and newsreels are usually licensed to exhibitors on a flat or weekly basis.

Over the years, film rental expense and the unsettled liability under film contracts have probably been two of the most troublesome accounts for exhibitors' accountants and auditors to deal with. This was primarily due to trade practices in effect and to the fact that, in spite of the most carefully planned accounting system for the recording of feature film transactions, the film buyer carried the key to final film costs in his private notebook or in his head. It was not unusual for final film costs on a feature production to remain an estimated figure until after an entire season's (a one-year period beginning about September 1) product had been played.

On November 20, 1940, the U. S. Government and the five major defendants and their subsidiaries, in the anti-trust proceedings known as *U. S. vs. Paramount Pictures, Inc., et al.* executed a written consent to the entry of a decree by the United States District Court, which laid down certain rules for the distribution of film by the defendants. Since the 1940 date, various rulings on the subject have been issued by the courts and certain of the defendants have entered into consent decrees which not only govern their distributing policies but acquiesce in the divorcement of their exhibition and production-distribution activities.

These events have, of course, changed film procurement procedures considerably. It is impractical to attempt a presentation here of all the rules, regulations, and trade customs governing feature film procurement, but the following general observations of practices now in effect may be of interest:

1. Films are not generally licensed until they have been trade-shown (previewed by exhibitors) in the area.
2. Films are licensed individually for each theatre.
3. In locations having more than one theatre, distributors designate the run and clearance time between runs. That is, which theatre, because of seating capacity, drawing ability, scale of admission prices, etc., may show a picture first, second, etc., and how many days must elapse before a subsequent run theatre may show the picture. In large cities, the distributors also designate the zone or neighborhood in which a theatre is placed. Theatres are often put in different areas by competing distributors and one distributor may even revamp his areas for the purpose of certain photoplays.
4. If there is only one theatre in the area or if the theatre operator in the area is satisfied with the run offered, he attempts to secure product on the best possible terms for his house.
5. However, in the event that there are two or more houses in an area which claim the same run, some distributors may offer their product for that run on the basis of bids but reserve the right to reject any and all bids. After the time has elapsed on the bids and none are found satisfactory, the distributor may open direct negotiations for the license of his picture to any exhibitor in the zone.
6. These observations are general and there are exceptions in the case of certain distributors and in locations where local courts or circumstances have brought about departures.

As a rule, film procurement for an entire circuit is accomplished by the home office film buyer. The terms of each rental are contained in contracts or booking forms and the theatres may be furnished with copies thereof or otherwise notified of the pertinent dates, terms, and advertising arrangements as far in advance of playdates as practical. Final payment to the distributor is usually made by the home office within seven to fifteen days after the final exhibition date of the film. In the case of percentage engagements, the liability will be determined from box office and other data submitted by the theatres, as commented upon later. First features are usually purchased on a percentage basis while second features are often purchased on a flat price basis. A distributor may license two pictures as a double feature and sell them as 50/50 billings, 60/40 billings, or ⅔-⅓ billings, but the terms for each picture

must be clearly established in the contract.

Rent represents a substantial expense of circuits leasing theatres. Theatre leases are generally complicated legal documents in which the attorneys for the landlord and for the tenant have amalgamated their best business and legal talents. As a result, the terms of the various leases may vary in many respects. These contracts may cover a period of years and provide for an annual rental (fixed, percentage, or a combination of both) to be paid over the life of the lease, how the rental will be calculated, the payment of taxes and insurance, together with a multitude of other matters.

The procurement by exhibitors of advertising material and space are not uncommon transactions but the so-called "co-op" advertising is worthy of comment. Co-operative advertising is a trade term for that advertising expense, shared by the distributor and the exhibitor. The distributor's share of the box office receipts on "hit" photoplays usually amounts to 35% or more on pictures sold on a percentage basis, and it may be advantageous for him to push a particular picture in certain situations by expanding upon the exhibitor's normal advertising. The entire expanded advertising campaign may be placed by the exhibitor who inserts ads in his local newspaper 365 days a year and thus obtains a better rate than the distributor. A substantial portion of the exhibitor's expenditures must be made locally at the theatres while the final film settlement, less allowance for co-operative advertising, is made at the home office. After final settlement with a distributor has been made on a particular picture, it may be embarrassing for the exhibitor's home office to receive additional vouchers from theatres for art work and other expenses relating to the advertising of the photoplay as it is sometimes difficult to obtain credits from distributors for tardy advertising claims.

Theatre salaries present no great problems except for the fact that they are usually paid at theatres and that there is a very rapid turnover in certain theatre personnel. Reliance must be placed on the local theatre manager for close supervision of his payroll, for which receipts (signed by the employees) are usually submitted to the home office. Payoffs are witnessed by home office auditors or representatives when practical. The salaries of engineers, operators, stage hands, and certain other employees are often subject to the terms of contracts with labor unions and such contracts should serve as a guide in dealing with this expense.

The usual expense items found on a theatre profit and loss statement, except for certain home office charges, are shown on the work sheet illustrated below. Except for the items already dealt with, such expenses should pose no special problems.

Theatre and Building Forms

Theatre and building forms are designed to furnish management with the necessary operating and accounting data and, in addition, provide the maximum accounting checks and controls. Forms discussed in the following paragraphs represent only the more important accounting forms of the chain exhibitor. Such forms provide certain accounting controls at the theatres and buildings themselves, and also provide the home office with the tools required for further follow-up and audit there. The more important home office internal audit features relating to the threatre and building operations are set forth along with the description and usage of each form.

The admission ticket is probably worthy of first consideration. Tickets are generally purchased and distributed to the theatres by the home office. Although some variation exists, the following ticket practices are general:

(1) Each ticket contains, among other things, the name of the theatre, the admission price and taxes thereon,

and a serial number. The serial number is usually found at both ends of the ticket so that the patron's half as well as the half retained by the doorman will bear the same number.

(2) Distinctive colors are usually employed for each admission price.

As cashiers go on duty, they are generally furnished with a proof sheet, a change fund, and rolls or strips of tickets to be issued during that price period. Proof sheets may be prepared in duplicate as the cashier goes off duty or at the time of price changes. The theatre manager or his representative will check the accuracy of the document and receipt one copy for the cashier turning in unsold tickets and funds. The other copy of the proof sheet is retained at the theatre and serves as the posting medium in the preparation of the daily box office report. Proof sheets may show the beginning and closing ticket numbers, the number of tickets sold and the gross value thereof, refunds, tickets issued in error, tickets sold at a discount, passes, special or advance sale of tickets and cashier's overages or shortages. Special forms are sometimes provided theatres for hourly ticket sales reports, season pass reports, daily pass-in lists and refund envelopes.

The daily box office report may be prepared from cashiers' proof sheets and will show in summary form all data contained on the latter form, together with any other monies received at the theatre from sale of merchandise or other sources during the day. A special box office report is usually prepared for midnight shows inasmuch as percentage film rentals of such shows vary from that of other performances. Copies of the daily box office report, ticket stubs taken by doormen, doormen's reports, and other required forms are usually submitted to the home office daily. In the event that the current film attraction is rented on a percentage basis, a copy of the daily box office report may be prepared for certain distributors.

The daily data which has been furnished the home office may serve as the source of admission and sales statistics for management; the basis for film buying (an attraction may be "pulled" or it may be "held over" depending upon its success at the box office); the posting media for the daily cash receipts records; and for audit purposes. The home office unit assigned to the audit of the daily box office reports usually confines itself to the following:

(1) Checking the mathematical accuracy of all reports submitted.

(2) Comparing amounts deposited in banks with receipts shown on the daily box office reports.

(3) Maintaining a perpetual inventory of admission tickets on hand and used by theatres.

(4) Accounting for all ticket numbers sold at one or more theatres by examining the ticket stubs submitted by the theatres. The theatres to be checked may be selected by some plan of rotation, because of changes in theatre personnel or because of suspicious circumstances or other information.

Weekly statements or cash reports (see illustrations on pages 114 and 115) are prepared by theatre and building managers and show all receipts and expenditures for the week. Certain large circuits stagger the weekly closings to fit the exhibition policy of the various houses and to spread over the entire week the work of the home office. Weekly statements are designed to show as correctly as practical the weekly operating results of each theatre or building. The weekly Theatre and Building reports, illustrated on pages 116-117, are typical of the reports submitted to home offices in the larger circuits, while the illustrated Theatre Profit and Loss work sheet (pages 118-119) is used by the home office for summarizing by account classification the transactions shown on the weekly reports and as a source document for punch card operation.

Total cash receipts, as shown on the

(Text continued on page 120)

THEATRE WEEKLY CASH REPORT

THEATRE ______ CITY ______ WEEK ENDED ______ (DAY) ______ (DATE) 19__

		BOX OFFICE RECEIPTS (EXCLUSIVE OF ADMISSION TAXES AND WELFARE FUND COLLECTIONS)						FOR HOME OFFICE USE ONLY
		MATINEE		EVENING		TOTAL DAY		
DAY	DATE	PAID ATTENDANCE	AMOUNT	PAID ATTENDANCE	AMOUNT	PAID ATTENDANCE	AMOUNT	
THURS		3 047	1 728 90	5164	3 726 30	8 211	5 455 20	
FRI		2991	804 35	2536	1588 15	5 527	2 392 50	
SAT		1526	884 01	4527	2973 15	6053	3 857 16	
SUN		2353	1 293 13	5048	2443 29	7401	3 736 42	
MON		963	336 67	1003	569 23	1966	905 90	
TUES		938	369 77	1643	805 75	2581	1175 52	
WED		614	314 39	1742	877 32	2356	1191 71	
SPECIAL PERFORMANCES								
SAT (Midnight)				2024	625 55	2024	625 55	
TOTALS		12 432	5 731 22	23 687	13 608 74	36 119 (611-00-74)	19 339 96 (102-00-01)	

OTHER OPERATING INCOME

VENDING MACHINES—CANDY		162 19	
—CIGARETTES			
—SANITARY		4 20	
—PAPER CUPS			
—POPCORN		383 06	
—WEIGHING: PERIOD	TO		
—BEVERAGES: PERIOD	TO		
—LOCKERS			
	TOTAL	(109-00-03)	549 45
TELEPHONE COMMISSIONS: PERIOD	TO	(110-00-04)	
CASHIERS' OVERAGES		(111-00-05)	
MISCELLANEOUS INCOME (LIST IN DETAIL)			
	TOTAL	(113-00-06)	
		TOTAL OPERATING INCOME	19 889 41

OTHER RECEIPTS

OTHER RECEIPTS	C. R. No	
REMITTANCES FROM HOME OFFICE	110	
BOX OFFICE CHANGE REDEPOSITED	130	2 500 —
RENTS FROM STORES AND OFFICES	250	
WELFARE FUND COLLECTIONS	215	14 94
ADMISSION TAXES COLLECTED—FEDERAL	211	3 825 44
—STATE	212	
GROSS RECEIPTS TAX—CITY	230	581 46
PAYROLL DEDUCTIONS—F. O. A. B.—EMPLOYEES'	221	13 33
—U. I. C. —EMPLOYEES'	223	
FEDERAL INCOME TAX—EMPLOYEES'	225	242 90
STATE INCOME TAX —EMPLOYEES'	226	
CITY INCOME TAX —EMPLOYEES'	227	
GROUP LIFE INSURANCE PREMIUMS	214	
BLUE CROSS HOSPITAL SERVICE	310	

(Theatre Weekly Cash Report--Contd.)			
EMPLOYERS' SHARE—F.O.A.B.	222	13 33	
—UIC	224	39 99	
A's SHARE OF CANDY RECEIPTS	240	954 75	
B's SHARE OF EXTRA ADV.	240	289 76	
MERCHANDISING ACCOUNT - TOTAL CASH RECEIPTS	450		
TOTAL OTHER RECEIPTS			8 475 90
TOTAL CASH RECEIPTS			28 365 31
LESS—TOTAL CASH DISBURSEMENTS			28 365 31
EXCESS OF RECEIPTS OVER DISBURSEMENTS		120	—
BANK BALANCE AT BEGINNING OF WEEK			1 750 —
BANK BALANCE AT END OF WEEK			
BOX OFFICE FUND			
(FOR HOME OFFICE USE ONLY)			

ANALYSIS OF COST OF SHOW

PLAY DATES TITLE OF FILM — NAME OF ACT	DISTR.	TERMS	RECEIPTS BY FEATURE	FEATURE COST (INCLUDING SALES TAX)	SHORTS COST (INCLUDING SALES TAX)	STAGE ATTRACTIONS	CONTESTS	(MEMO) SALES TAX
FEATURE X			18 714 41	7 017 90				
MIDNIGHT SHOW			625 55	172 03				
NEWS					37 50			
NEWS					37 50			
SHORTS					100 —			
SHORTS					37 50			
PRODUCTION						4 64		
TOTAL	XXX	XXX	19 339 96	7 189 93	212 50	4 64		

I HAVE EXAMINED THIS REPORT AND CERTIFY IT IS CORRECT:

MANAGER

BOX OFFICE TREASURER

BUILDING REPORT

Building____________________ (__________) City____________________ Period Ending____________________ 194___

TO BE COMPLETED AT BUILDING OFFICE		(Debits—Black) • For Home Office Use Only • (Credits—RED)					Tab. Punching only Increase—Black (x) Decrease—RED	
CHARGES TO TENANTS ACCOUNTS (PER RENT COLLECTION REPORT)	AMOUNT	ADJUSTED BALANCES	General Ledger	TAB. CODE	Building P & L	Tenants Accounts Receivable	TAB. CODE	Amount
Rent - Other Sources							107 00-04	
Rent - Commercial Space Stores and Offices	38 620 –						108 00-05	1 841 68
Electricity & Power	1855 20						112 00-07	1855 20
Interest	9 17						351 00-61	9 17
Miscellaneous, Water, Heat, Gas	45 86						113 00-08	45 86
							108 00-05 –	36778 32 –
TOTAL CHARGES	40 530 23							
Deduct - Rental Concessions							108 00-05	
TOTAL DEDUCTIONS								
NET CHARGES (a)	40 530 23				40 530 23 C	40 530 23		
CASH RECEIPTS AND DISBURSEMENTS		FOR HOME OFFICE USE ONLY						
CASH RECEIPTS								
Collections From Tenants:								
Accounts Receivable (b)	44 018 29							
Notes Receivable								
Rental Deposits								
Total Collections From Tenants	44 018 29							
Remittance From Home Office	4773 53		4 773 53 C					
Redeposit of Employees Contributions to F.O.A.B. and Fed. & State Unemploy. Ins.	374 74							
Sundry Other Receipts not Income (Furnish Details)	37 50							
Miscellaneous Income (Furnish Details)								
							113 00-08	
TOTAL RECEIPTS	5 185 77							

Note—Item (b), amount of $44,018.29, has not been extended to Tenants Accounts Receivable column as funds were deposited in a local home office bank account and this item is posted to the Accounts Receivable Control account in the General Ledger from the home office Cash Receipts book.

(Building Report—Contd.)

CASH DISBURSEMENTS							
Remittance To Home Office							
Employees Contribution to F.O.A.B. and Fed. & State Unemployment Insurance	374 74						
Sundry Other Disbursements Not Expense (Furnish Details:)	37 50						
	20 —		20 —				
	66 78				66 78		
Expense Disbursements (Per Details Below) (c)	7730 95			7730 95		See Below	7730 95
TOTAL DISBURSEMENTS	8229 97						
Excess of Receipts Over (Disbursements) *	3044 20 Cr		4753 53 Cr	32799 28 Cr	40597 01	net	32799 28
Balance at Beginning of Period *	3726 47						
CASH BALANCE AT END OF PERIOD *	682 27						
Petty Cash Fund	25 -						

SUMMARY OF TENANTS ACCOUNTS RECEIVABLE

TO BE COMPLETED AT BUILDING OFFICE	AMOUNT	FOR HOME OFFICE USE ONLY
Balance Beginning of Period	35519 20	
Add - Net Charges (As Above) (a)	40530 23	
	66 78	
TOTAL	76116 21	
Deduct - Collections (As Above) (b)	44018 29	
Home Office Collection	1500 —	
TOTAL DEDUCTIONS	45518 29	
BALANCE END OF PERIOD	30597 92	

DETAILS OF EXPENSE DISBURSEMENTS

ACCOUNT (TO BE COMPLETED AT BUILDING OFFICE)	TAB. CODE	AMOUNT	FOR HOME OFFICE USE ONLY
HEAT—INCLUDING SALARIES:			
Fuel and Gas	243 29-13	3 85	
Repairs	243 27-14		
Other Expenses	243 38-15		
Salaries	230 11-16	356 55	
MAINTENANCE AND REPAIRS:			
Repairs—General	243 27-18	527 93	
Supplies and Expenses	243 39-19	150 34	
Contracts—Cleaning	243 38-20		
Contracts—Elevator	243 38-21		
OTHER EXPENSES:			
Advertising	243 24-31	56 82	
Telephone—Telegraph—Postage	243 26-36	44 12	
General and Miscellaneous	243 38-38	18 58	
Federal Old Age Benefit and Fed. & State Unemployment Ins.	243 40-39	234 16	
Stationery and Printing	243 44-35	15 75	
Brokerage	243 38-32		
Legal and Professional	243 39-33		
Management	243 38-34		
General Office Expense	233 00-30		
Electricity	243 28-28	536 61	
Water	243 30-29		
Taxes	243 49-42		
SALARIES:			
Supervision and Clerical	230 18-23	270 —	
Elevator Operators	230 18-24	1302 22	
Carpenters—Electrician—Painters	230 18-25	106 87	
Porters and Janitors	230 18-26	3846 07	
Night Watchmen	230 18-27	261 08	
TOTAL EXPENSE DISBURSEMENTS (Carried To Cash Section Above)	(c)	7730 95	

FOR ACCOUNTING DEPARTMENT USE

	Date	By		Date	By
Audited			Profit & Loss Ledger		
Deposits Verified			Remittance Register		
Extensions Checked					

I have examined this statement and certify it is correct. All bills applying to the current period are included and have been paid.

Manager

*** If receipts exceed disbursements, or if opening or closing balance represents an actual balance, such amount is to be typed in the usual manner.**

If disbursements exceed receipts, or if opening or closing balance represents an overdraft, such amount should be shown preceded by the letters O. D.

ORIGINAL — THEATRE AUDIT. DEPT.
DUPLICATE — REAL ESTATE DEPT.
TRIPLICATE — BUILDING FILE COPY

③ **THEATRE PROFIT AND LOSS**

THEATRE ____________ CITY ____________ WEEK ENDED ____________ (DAY) ____________ (DATE) 19___

	C.R. No.			
OPERATING INCOME				
BOX OFFICE RECEIPTS		102-00-01	19 339	96
VENDING MACHINES		109-00-03	549	45
TELEPHONE COMMISSIONS		110-00-04		
CASHIERS' OVERAGES		111-00-05		
MISCELLANEOUS		113-00-06		
RENTAL OF THEATRE		106-00-08		
TOTAL OPERATING INCOME			19 889	41
OPERATING EXPENSES				
STAGE ATTRACTIONS		229-00-17	4	64
CONTESTS		243-36-18		
OWN FEATURE FILMS		226-02-19		
OTHER FEATURE FILMS		226-03-20	7 189	93
OWN SHORTS		226-04-21	137	50
OTHER SHORTS		226-06-23	75	00
HOUSE SALARIES		230-11-25	1 418	43
OPERATORS' SALARIES		230-12-26	457	28
ORCHESTRA SALARIES		230-13-27		
STAGE SALARIES		230-14-28	264	16
OVERTIME AND EXTRA SALARIES		230-15-29	80	36
F.O.A.B. & FED. & STATE UNEMPLOYMENT EXPENSE		243-40-30	54	16
ADVERTISING SALARIES		230-16-31	225	—
NEWSPAPER ADVERTISING		243-23-32	614	11
RADIO ADVERTISING		243-47-54		
OTHER ADVERTISING		243-24-33	338	81
LOBBY DISPLAY		243-25-34	47	06
TELEPHONE, TELEGRAPH AND POSTAGE		243-26-35	72	—
REPAIRS AND RENEWALS		243-27-36	64	44
ELECTRICITY		243-28-37	300	—
FUEL		243-29-38		
WATER		243-30-39		
HOUSE SUPPLIES		243-31-40	19	52
VENDING MACHINE SUPPLIES		243-32-41		
ELECTRIC LIGHT BULBS		243-33-42		
UNIFORMS		243-34-43	13	38
THEATRE PARTY DISCOUNTS		243-35-44		
CASHIERS' SHORTAGES		243-37-45	2	76
MISCELLANEOUS		243-38-46	233	30
SOUND SERVICE (IF PAID FROM THEATRE)		243-22-51		
LICENSES		243-45-52		
TAXES		243-49-53		
TOTAL CASH EXPENSES			11 611	84
PROVISION FOR FILM ADJUSTMENT	441	226-07-24		
FILM BOOKING EXPENSE	216	227-00-47	96	—
GENERAL OFFICE EXPENSE	218	233-00-48	820	—
SOUND SERVICE (IF PAID FROM HOME OFFICE)	442	243-22-51	8	25
PERIODICAL EXPENSES	443	243-42-55	443	—
PROVISION FOR MAINTENANCE	444	243-41-56	200	—
RENT	445	234-00-57	4 025	—
TOTAL HOME OFFICE EXPENSES			5 592	25
TOTAL OPERATING EXPENSES			17 204	09
NET PROFIT OR (LOSS)	410		2 685	32

(Theatre P. & L.--Contd.)

DISBURSEMENTS NOT EXPENSE

	C.R. No.		
REMITTANCES	110-09	8 662	93
BOX OFFICE CHANGE	130-09	1 500	-
WELFARE FUND COLLECTIONS	215-09	14	94
ADMISSION TAXES COLLECTED—FEDERAL	211-09	3 825	44
—STATE	212-09		
—CITY	213-09		67
GROSS RECEIPTS TAX—CITY	230-09		
GIFT BOOK COUPON REDEMPTIONS	217-09		
GROUP LIFE INSURANCE PREMIUMS	214-09		
BLUE CROSS HOSPITAL SERVICE	310-09		
BUILDING PROFIT AND LOSS	420-09		
PERIODICAL EXPENSES	320-09		88
MAINTENANCE	330-09	296	40
ACCOUNTS PAYABLE MISCELLANEOUS (LIST SEPARATELY)		x x x	x x
		x x x	x x
		x x x	x x
		x x x	x x
		x x x	x x
TOTAL	230-09		
ACCOUNTS RECEIVABLE MISCELLANEOUS (LIST SEPARATELY)		x x x	x x
		x x x	x x
		x x x	x x
		x x x	x x
		x x x	x x
TOTAL	240-09		
SUNDRY DEPOSITS (1420-20-00)	340-09		
DEFERRED INCOME (2400-20-00)	340-09		
HOME OFFICE -GENERAL OFFICE EXPENSE	218-09	820	-
-FILM BOOKING EXPENSE	216-09	96	-
-MISCELLANEOUS	219-09		
A VENDING CO.		954	75
GROSS RECEIPTS TAX - CITY		581	46
MERCHANDISING ACCOUNT - TOTAL CASH DISBUSEMENTS	450-09		
TOTAL DISBURSEMENTS NOT EXPENSE		16 753	47

RECONCILIATION	DEBIT		CREDIT	
NET PROFIT OR LOSS			2 685	32
TOTAL OTHER RECEIPTS	x x x	x x	8 475	90
TOTAL DISBURSEMENTS NOT EXPENSE	16 753	47	x x x	x x
LOCAL CASH				
RESERVES FOR HOME OFFICE EXPENSES	x x x	x x	5 592	25
TOTAL				

	DATE	BY		DATE	BY	LEDGER POSTINGS	DATE	BY
COMPLETED			ADDITIONS AND EXTENSIONS CHECKED			TAB.—PUNCHING		
AUDITED			DEPOSITS VERIFIED			TAB.—VERIFIED		
						LEDGERS		

APPROVED____________________

(Continued from page 113)

weekly cash report, represents a summary of receipts already reported for the week on daily box office reports. Details of cash disbursements may be listed by check number on the reverse side of the weekly cash report. Vouchers and detailed theatre and building payrolls, accompanied by receipts are submitted with the weekly reports. In order that each week will stand its proper share of monthly expenses, checks are sometimes drawn at theatres for estimated telephone, gas and electric charges weekly. Such checks are held until the actual bills are received, and after drawing a final check for an amount necessary to equal the total of the invoice, checks aggregating the amount of the liability are mailed to the supplier. The home office is usually reimbursed weekly for film service, administrative fees, rent, other accrued expenses, taxes collected and withheld, together with any excess of theatre or building receipts over disbursements. This practice places theatre and building cash funds on an imprest basis.

Home Office Records

The aforementioned reports have supplied the home office with sufficient data to permit (1) compiliation of fairly complete operating reports for the circuit within a short time after the close of the week, (2) completion of the audit of theatre and building receipts and disbursements and (3) the recording of local transactions in the general books.

Most of us will probably give our blessing to the audit of receipts and disbursements. However, the volume of documents flowing from theatres and buildings into the home office of a large circuit is heavy, and unless constant review and supervision is given to such audit procedures, we may be wasting money and at the same time drift into a false sense of security. It is unfortunate that all employees performing this type of auditing are not of CPA caliber, but budgets usually do not permit a full staff of expensive talent for this type of work.

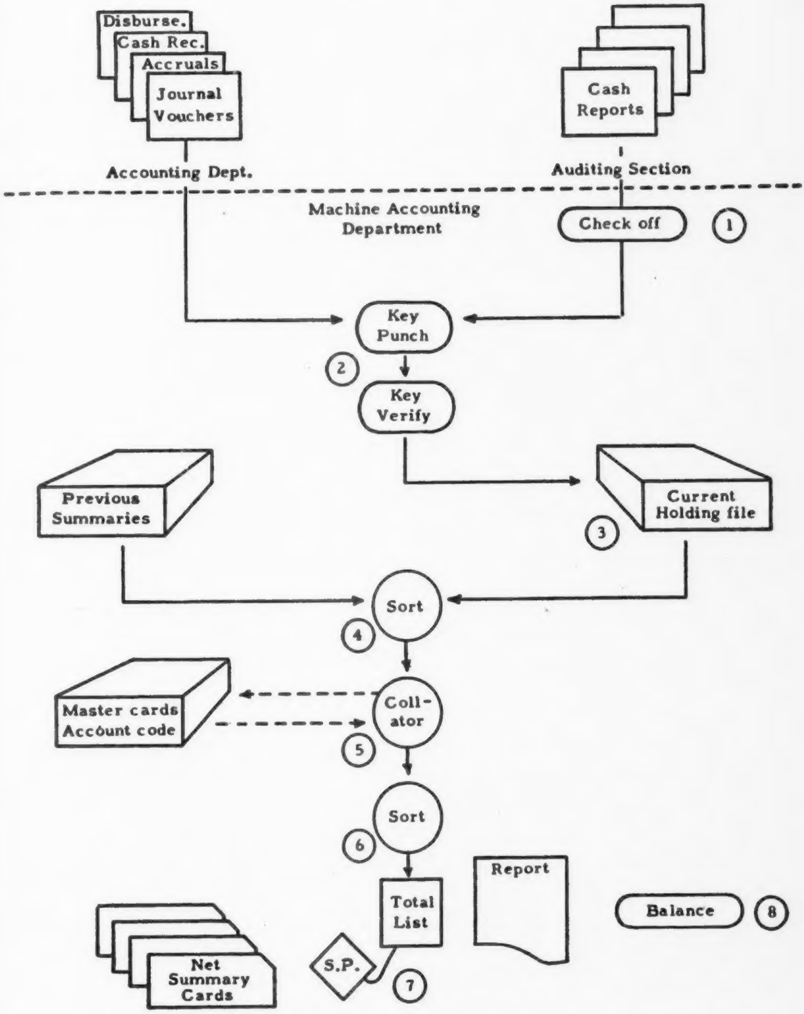
The recording of theatre and building transactions in the general books may be accomplished by several methods. The weekly reports are readily adaptable to recording on peg-board forms. Certain hand posting to the general ledger and other records cannot be avoided but the peg-board method lends itself to rapid summarization and tabulation into desired groupings of operating statements and other data which may be converted into permanent records by means of photographic reproduction. Tabulating (punch card) equipment is also employed by the larger circuits for the purpose of providing information relating to profit and loss and other accounts.

The punch card procedure developed by one theatre chain has proven most effective for the keeping of certain sub-ledgers and the profit and loss accounts. This organization is currently able to complete all theatre and corporate profit and loss statements within two days after the final entries have been received. For those who are interested in punch card application, a summary outline of this exhibitor's procedure* together with a flow chart* (which has been keyed to the outline) follows:

1. A check-off control is maintained to ensure receipt of all source documents.
2. Cards are punched and verified daily from precoded source documents.
3. Key punched cards are placed in a holding file until the month's work has been completely punched.
4. At month-end, each type of profit and loss current month's cards is combined with the previous month's summary cards and sorted by account number and functions.
5. At this point these cards are run through the collator and matched against a set of master account cards to show up any "impossible" codings.

* Furnished through the courtesy of Mr. Walter Hoffman of RKO Service Corporation; see pages 121-122.

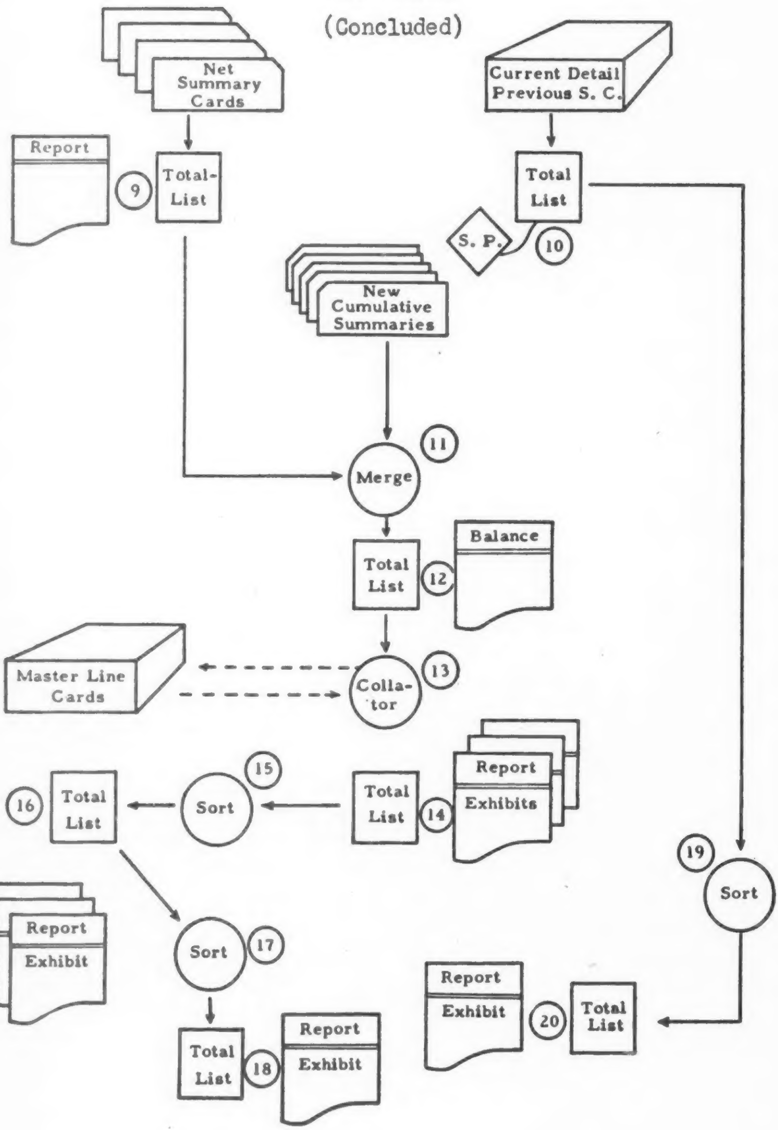
FLOW CHART



(Continued on Next Page)

FLOW CHART

(Concluded)



6. Cards are sorted by property and company.
7. A summary report is made and a summary card is cut for the net profit or loss of each property.
8. The net profit and loss totals are checked against the control accounts in the general ledgers.
9. Net summary cards are crossfooted. (Previous month accumulation plus adjustments of prior months plus total current month equals accumulation to date. Cash reports and building reports plus home office equals total current month.)
10. The current month detail and prior month cumulative summary cards are total-listed and a summary card is cut for each account within each property.
11. Net summary cards and account summary cards are merged.
12. Net summary cards and account summary cards are total-listed, adding account summary cards, subtracting net summary cards for a zero balance.
13. Cards are matched-merged against line cards.
14. Theatre, building, and financial and other profit and loss statements are prepared using the accounting machine.
15. Cards for each corporation are sorted by corporate account.
16. Additional consolidated statements are prepared.
17. Certain expense accounts are selected for sorting.
18. Corporate analysis of expense report is prepared.
19. The detail cards used to prepare the profit and loss statements are sorted periodically.
20. A permanent listing of the detail items is prepared.

The general ledgers, cash books, and other books of original entry, together with subsidiary records, such as accounts payable, property registers and accrual registers, used by chain exhibitors do not differ greatly from those of other chain businesses. The film liability record is perhaps the only such record requiring special comment here. This record is usually hand posted from information contained on the weekly theatre cash reports and shows the exhibitor's liability for each theatre in respect of each photoplay exhibited. The control section of the ledger will show the total liability to each distributor for the various photoplays exhibited. Home office adjustments to the film liability record cash reports are posted from documents supporting the related journal entries, while payments to the distributors may be posted from the cash disbursement vouchers.

In addition to the internal audit procedures already mentioned, certain of the larger exhibitors employ traveling auditors and sometimes outside organizations to perform certain checking and investigation activities at theatres and buildings.

The Independent Auditor

The extent of the outside auditor's examination of transactions will of course depend to a great extent upon the exhibitor's accounting checks and controls and on the value of internal audit work actually accomplished by the client. It would appear that these matters should be carefully considered before the outside auditor attempts to prepare his work programs and otherwise plan his examination.

The nature of the business lends itself very well to the carrying out of substantial amounts of interim work. Both accounting and internal audit procedures and reports can be reviewed and the auditor's files brought up to date. Theatre and building transactions may be examined for selected periods during the year. Analyses of changes in capital asset and various other accounts, including those in the expense category, might well be brought up to a certain point. A test of admissions and other theatre operating income and expenses will usually be carried out in conjunction with the interim cash examination as a substantial portion of theatre income and expenses is originally reported on daily box office and weekly theatre cash reports.

The examination of feature film expense for a selected period is preferably carried out during the interim examina-

tion. It may be desirable to select certain theatres of the circuit and carry out desired audit procedures for selected periods. It may not be practical to cover every theatre in the circuit during each examination. However, the selection may be so planned that all the theatres are covered over a period of two or three years. The audit procedures relating to film expense should include a check of the liability set up for each photoplay exhibited during the period selected for the test by reference to cash reports, film booking contracts, etc., and the final liquidation of such liabilities. Confirmation of liabilities may be attempted in conjunction with the interim examination; however, confirmation as of the balance sheet date may prove more practical and bring in a greater number of replies. One difficulty in obtaining confirmation of film liabilities lies in the fact that most of the distributors maintain their accounts receivable records at branches throughout the United States, which would necessitate confirming with each branch with which the circuit does business.

In instances where interim work has been carried out along the lines already mentioned, the year-end examination will not differ greatly from that made of other chain organizations. Accounts receivable will generally consist of rents due from tenants and miscellaneous receivables from distributors and others. However, the amount of the receivables rarely constitutes a large portion of the assets. Inventories are usually of minor importance and consist primarily of merchandise held for sale in theatres, together with material and supplies inventories.

In most instances accounts payable consist primarily of liabilities to contractors for maintenance and repair work, admission and other taxes and the exhibitor's liability to distributors of film. A portion of this liability will represent the approximate amount owing for partial playoffs. If a photoplay has been licensed for a five day run and only three days of the run have elapsed as of the balance sheet date, a portion of such rental is set up as a liability. In the event of percentage engagements, the percentage called for by the contract is applied to the admissions earned on the photoplay as of the balance sheet date. It is customary to allocate the cost of the flat rentals over the days of the week on a 10 unit basis. Under this method, one unit is allocated to each day from Monday through Friday, two units for Saturday and three units for Sunday. Thus, if the photoplay was rented on a flat basis for the five days ending on Wednesday and the balance sheet closing came at the close of business on Monday, $\frac{3}{4}$ of the total liability would be set up as follows:

$$\frac{\text{Saturday through Monday}}{\text{Saturday through Wednesday}} = \frac{\text{6 points}}{\text{8 points}} \text{ or } \frac{3}{4}$$

The remaining items in the balance sheet and the profit and loss statement are not unusual from the audit viewpoint except as commented upon earlier.

Outside auditors have been known to express dismay at the thought of auditing punch card records. It has been my experience that such records lend themselves very readily to auditing provided that the auditor's requirements are made known well in advance and that he receives the full cooperation of those responsible for the punch card operation. For example, let us assume that the auditor wishes to review the repairs and renewals account and examine certain related vouchers. If the supervisor of the punch card operation has been sufficienlty prepared for such a request, he can, without too much difficulty, list in detail by property and corporation all such expenditures for the period. Or if it is desired, he can list all items over a given amount. Such listings may be prepared to suit the auditor's requirements and should

include voucher and other source document references. Generally speaking, the same can be accomplished for all accounts for which punch cards are available. Certain basic auditing principles must, of course, be observed by the auditor in dealing with such analysis, but would not the same precautions be advisable in dealing with records and schedules prepared manually by his client?

It does not appear feasible to discuss pooling operations and other types of transactions which are no longer entered into by the major exhibitors. However, in closing there remains one thought which may be worthy of mention concerning the records necessary for a rapid and orderly consolidation of the accounts of the many corporations sometimes found in a movie theatre chain. Due to innumerable changes over the years in the corporate structures of most chain exhibitors because of bankruptcies, mergers, sales, acquisitions of various types, etc., adequate historical records of investments, capital stocks, surpluses, and consolidating adjustments become an absolute necessity. Time spent at each closing bringing such data up to date and writing complete explanations for any changes may seem unnecessary while the transactions are still fresh in the minds of all concerned, but experience with the subject has taught many of us the value of having such data available.

Pointers on the Technique of Writing Audit Comments

(Continued from page 88)

is used when the object is spoken of as not yet being there. Thus we say, "the site *of* the factory," but "land purchased as a site *for* an office building."

After *security, for* is used; after *collateral, to* or *under.*

After *purchase, of* and *from* are used as follows: "The purchase *of* land *from* the Midtown Realty Company was authorized by the board of directors;" or, "The land was purchased *from* (not *of*) the Midtown Realty Company."

That brings us to conciseness, or the art of making one word do the work of two. Conciseness has been touched upon at several points in connection with other matters. Clear thinking and conciseness go hand in hand.

There is no need to say that "the reserve for doubtful accounts appears to be ample to provide for losses in the collection of the accounts receivable." All that is necessary is to say that "the reserve for doubtful accounts appears to be ample." If we reviewed the accounts with the credit manager we do not need to say that "in his opinion they are considered collectible," but only that "in his opinion they are collectible."

Such expressions as *cost price* and *cost value* may be reduced to the one word *cost.* The word *remains* means *is still* and we do not need to say *still remains.* Nor does the word *actual* add anything to the meaning in the phrase "by *actual* count." If we have completed an operation we do not need to say that it is *fully* completed.

There is a great deal of uncalled-for repetition of words in tabulations. Under *reserves,* it is not necessary to repeat the word *for* before each item. Also we may usually eliminate, in the description of the items, words which are contained in the heading; as in the following:

Subscription accounts:
  Unpaid capital stock subscriptions
  Unpaid building fund subscriptions.

Such a tabulation might better read:

Subscription accounts:
  Capital stock
  Building fund.

Applying Auditing Procedure Statement No. 23 (Revised) In Practice

(With Special Reference to Small and Medium-Sized Practitioners)

By David S. Siegel, C.P.A.

This discussion is primarily intended to review the application of Auditing Procedure Statement No. 23 (revised) to the reports of small and medium-sized practitioners, but the principles involved have equal application to large practitioners.

I believe that we ought first to clarify the distinction between so-called large, medium-sized and small practitioners. Is a large practitioner one who has more clients than the number which a smaller practitioner serves? I do not think so. Rather should the determining factors be the size of the client in terms of his financial resources, the amount of his business measured in dollars and cents, the number of personnel required to operate his business, etc. When the accountant has expanded his practice to the extent that he serves many such large businesses, his own organization, of necessity, must increase. He then maintains a staff of many senior, semi-senior and junior accountants, and even supervisors, principals, etc. In the eyes of the accounting profession and the business world he is now a large practitioner.

David S. Siegel, C.P.A., is Chairman of the Society's Committee on Auditing Procedure. He is a partner in the firm of Klein, Hinds & Finke, C.P.A's. Mr. Siegel has been a member of our Society since 1930, and is also a member of the American Institute of Accountants. He was formerly an instructor in auditing in the Evening Session of the School of Business and Civic Administration of The City College of New York.

This paper was presented by him on December 13, 1950, at a technical meeting, conducted under the auspices of the Committee on Auditing Procedure at the Engineering Societies' Building in New York City.

For the purpose of this discussion, let us accept the foregoing definition of the large practitioner as a working basis, and agree that all other practitioners who are not large are either of medium-size or small. Why, then, in the application of Statement 23, should any distinction be made between the so-called large or small practitioner? Perhaps, the reason is that the large practioner is not called upon as often as the smaller one to determine whether the scope of his audit prevents him from expressing an unqualified opinion on the financial statements under review. Normally, large business enterprises desire and welcome the extensive audits required for the expression of unqualified opinions. This is especially so if the audit is required in connection with stockholders' reports, SEC reports, etc., and when the accountant's unqualified opinion is essential and must accompany the financial statements submitted by corporations to interested parties. In such cases, there is no need to determine whether an opinion should or should not be expressed. The purpose of the auditor's examination is to perform all of the auditing procedures required for the submission of the usual unqualified certificate (see Form A in the Appendix).

If all audits made by all practitioners were conducted for the purpose of rendering an unqualified report, Statement No. 23 need never have been written. However, it was necessary be-

cause the auditor is called upon to render various types of services as a result of which he renders a report. Some of these services are not intended to result in unqualified opinions, and this is equally applicable to large practitioners as well as to small and medium-sized ones. The time has not yet arrived, if it ever will, when the independent public accountant may insist that his client agree to the performance of that type of audit which permits him to render an unqualified opinion.

The auditor's reports which come within the purview of Statement No. 23 may be either long-form or short-form. It is with respect to the long-form report, particularly, that the reader may be confused as to whether, in the auditor's opinion, the statements submitted present fairly the financial data with which they are concerned. This type of report often contains pages and pages of comments on the various assets and liabilities, and the income and expense items. Yet, when the interested party has concluded the reading of the report, he must himself determine, if he can, whether the auditor has transmitted an unqualified opinion, or a qualified opinion, or has disclaimed any opinion.

This difficulty should not be present in the short-form report, where the comments, if any, generally in the form of footnotes, are comparatively few, and the audit certificate is clear as to the responsibility which the auditor has assumed with respect to the statements in question.

Let us apply Statement No. 23 to some specific types of auditor's reports, which would not reveal to the reader the extent of the auditor's approval of the financial data, if it were not accompanied by a definite assertion of opinion or disclaimer. After describing the report in question, I shall suggest the language of the qualified opinion or disclaimer of opinion which appears to be applicable. This is merely a suggestion, since Statement No. 23 does not contemplate "that the disclaimer of an opinion should assume a standardized form." Eventually, perhaps, a standard disclaimer may be adopted by the accounting profession, just as the short-form unqualified certificate has been adopted and is widely used today.

I have seen Balance Sheets and Profit and Loss Statements submitted by some accountants on ordinary letterheads, with the intention that they be used by the client in connection with negotiations with third parties. These statements were signed by the accountants in question with no comment as to the scope of the examination or opinion. Sometimes they bore no signature. Obviously, it cannot be clear to the reader of the statements whether he is examining an unqualified certified statement or merely figures transcribed from the books. In such circumstances, it would be normal for the reader to assume that the accountant is accepting full responsibility for the correctness of the contents of the statements. However, there may be no intention at all on the accountant's part to give that impression to the reader. This type of report may take other forms. It may appear on stationery, with or without the accountant's name thereon, but bound between covers bearing his name. At times, it may be in the form of a trial balance, with or without adjustments.

Statement No. 23 requires that the foregoing documents be accompanied by a statement indicating the extent to which the accountant assumes responsibility with respect to the financial data. If the scope of the audit permits an unqualified opinion, the usual certificate should be included in the report (See Form A in the Appendix).

Statement No. 23 states that

> "When an unqualified opinion cannot be expressed, the accountant must weigh the qualifications or exceptions to determine their significance. If they are not such as to negative the opinion, a properly qualified opinion would be satisfactory; if they are such as to negative the opinion on the statements taken as a whole he should clearly disclaim such an opinion."

The conclusion which the accountant reaches will be determined by him and

will be the result of his professional judgment. A qualified opinion may result, for example, from the difficulty of establishing, by standard auditing procedures, the fair value of material items, such as investments in foreign subsidiaries, or investments in non-marketable securities; from the failure to take a physical inventory in a war-time period; from non-confirmation of receivables due from U. S. Government agencies; from the inability to determine the results of pending renegotiation proceedings, or pending lawsuits, etc. If the accountant has satisfied himself by other means as to the fairness of the amounts involved, he is justified in expressing an opinion subject to qualification. The qualification may be in the form of stating an exception as to the scope of the audit or as to consistency with the method of accounting in the preceding year, as well as in the expression of the opinion. Form B, appearing in the Appendix, is an example of a qualification of the scope and the opinion.

Generally accepted auditing standards require that where the auditor intends to report over his signature on the financial statements of a concern in which inventories are a material factor, he shall, wherever practicable and reasonable, be present, either in person or by his representatives at the inventory-taking and, among other things, observe the client's procedure with respect thereto. Also, as to material amounts of accounts receivable, wherever practicable and reasonable, confirmation thereof by direct communication with the debtors is required. If the foregoing procedures are not followed when required, an unqualified opinion is not permissible. Form C, appearing in the Appendix, is a suggested disclaimer of opinion to be used when accounts receivable and inventories are not subjected to generally accepted auditing procedures.

The foregoing applies generally to all reports, and whether they are year-end or interim is immaterial. However, most interim reports are generally issued by the accountant as part of the continuous service rendered to the client throughout the year. For that type of report, the assets and liabilities are not examined and confirmed in such a manner as to permit the expression of an unqualified opinion. A disclaimer appropriate in these circumstances is submitted in Form D, appearing in the Appendix.

Quite often accountants are engaged to perform limited auditing services because the client is not interested in receiving an unqualified report nor in having an unrestricted audit. For example, he may require the services of the accountant primarily for the preparation of tax returns, and he requests that the examination of the books and records be confined to the ascertainment of only so much information as is required for this purpose. In addition, he also requests that a Balance Sheet and Profit and Loss Statement be prepared for his own use. Since some auditing is done, it would be appropriate to indicate that fact, but an opinion must be disclaimed. Form E, appearing in the Appendix, is suggested for this situation.

A special situation exists when the client's books are maintained on the cash basis. There may be no restrictions on the scope of the audit, and such assets and liabilities which are recorded in the books may be subjected to the usual independent confirmation. However, the financial statements prepared from such books give no effect to accrued assets, liabilities, income and expenses. If the latter are not material, the accountant would properly determine that their exclusion from the statements does not negative the opinion. Where the amounts are substantial and are not included in the statements so as to adjust the cash basis books for an accrual basis report, it would be improper for the accountant to state that the financial statements present fairly the financial position and results of operations. This calls for a disclaimer of

opinion, as suggested in Form F, appearing in the Appendix.

The foregoing examples deal with cases where some, if not all necessary, auditing procedures are performed and where the accountant's name is associated with the financial statements. In the event that the statements are prepared without audit and are presented on the accountant's stationery, no comment by the accountant is necessary, but there should appear prominently on each page of the statements a warning, such as "Prepared from the books without audit." This is considered sufficient compliance with Statement No. 23.

Financial statements are often prepared by accountants on plain paper, without any indication of the accountant's name nor of his part in the preparation of the statements. In such case, it is expected and intended that the reader will understand that he does not have an accountant's report before him. Obviously, Statement No. 23 is inapplicable here.

Not only the accounting profession, but also those who rely on auditors' reports, require education in the objectives of Statement No. 23. They should be made aware of the significance of the auditor's comments, as it relates to the responsibility he assumes or disclaims. At times, we accountants feel that not enough attention is paid by some clients to the comments in our reports, especially in the case of a voluminous long-form report. In my own experience, I have on occasion been told by a client that he never reads the comments. If all who make use of audit reports are made to understand the purpose of Statement No. 23, more attention will probably be paid by them to the reading matter which is intended to be helpful to the understanding of the contents of the reports.

Furthermore, educating the business fraternity with respect to Statement No. 23 should be helpful in bringing home to clients the fact that their accountants cannot always unqualifiedly "certify" their financial statements. They should understand that the auditor's opinion is limited by the extent of the audit and should realize that, if limitations are placed on the scope of the auditor's engagement, the extent of the reader's reliance thereon will also be necessarily limited. Unfortunately, not all of our clients are aware of the shortcomings of limited audits not only with respect to the accountant's opinion, but also as to the safeguarding of the assets of the business. The effect of Statement No. 23 should be to "break the news" to them, and if it is universally adhered to by the accounting profession, it will be impossible for a client to take the attitude that if accountant A will not render the desired cerificate then accountant B will do so, at no additional auditing cost.

In conclusion, some practitioner may inquire why all this fuss and bother, when the report is intended only for his client and is never submitted to third parties? Unfortunately, there is no guaranty that this will be the case, especially if the client insists on a report with the accountant's signature appended thereto. We auditors are not in control of the ultimate disposition of our reports, and, for our own protection, we should prepare reports with the thought always in mind that they may find their way into the hands of someone other than our client.

Appendix

Form A—Unqualified Opinion:

We (I) have examined the Balance Sheet of X Corporation as of December 31, 1950, and the related Statement(s) of Income and Surplus for the year then ended. Our (my) examination was made in accordance with generally accepted auditing standards, and, accordingly, included such tests of the accounting records and such other auditing procedures as we (I) considered necessary in the circumstances.

In our (my) opinion, the accompanying Balance Sheet and Statement(s) of Income and Surplus present fairly the financial position of X Corporation at December 31, 1950, and the results of operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceeding year.

Form B—Qualified Opinion:

We have examined the Balance Sheet of X Corporation as of December 31, 1950, and the related Statement(s) of Income and Surplus for the year then ended. Except that it was not practicable to confirm receivables from U. S. Government agencies, as to which we have satisfied ourselves by means of other auditing procedures, our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Certain contracts with the U. S. Government are subject to renegotiation, and the effect thereof upon the accompanying statements cannot be determined at this time.

In our opinion, subject to the determination of liability, if any, to the U. S. Government resulting from renegotiation proceedings, the accompanying statements present fairly the financial position of X Corporation at December 31, 1950, and the results of operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Form C—Disclaimer of Opinion:

(Accounts receivable and inventory not confirmed)

We have examined your books and records for the year ended December 31, 1950, and submit herewith a Balance Sheet at December 31, 1950, and an Income and Profit and Loss Statement for the year then ended. Since we did not independently confirm the accounts receivable and were not present at the inventory-taking, we cannot express an opinion on the statements as a whole.

Form D—Disclaimer of Opinion:

(Interim Audit)

We have made an interim audit of the books and records of X Corporation for the nine months ended September 30, 1950. In accordance with our usual practice in connection with interim audits, we did not independently confirm the assets and liabilities, since this is ordinarily done at the end of the fiscal year. Therefore, we cannot express an opinion on the statements submitted herewith.

Form E—Disclaimer of Opinion:

(Limited Audit)

Pursuant to instructions, we have made a limited examination of your books and records for the year 1950, primarily for the purpose of obtaining such data as were required for the preparation of federal and state income tax returns. At your request, we have prepared and submit herewith a Balance Sheet at December 31, 1950, and an Income and Profit and Loss Statement for the year then ended, which are in agreement with your books. Because of the limitations of our examination, we express no opinon on the statements submitted herewith.

Form F—Disclaimer of Opinion:

(Cash Basis)

We have examined your books and records for the year 1950, and submit herewith our report consisting of a Balance Sheet at December 31, 1950, and an Income and Profit and Loss Statement for the year then ended. Your books are maintained on the "cash receipts and disbursements method" and the financial statements have been prepared on that basis. Consequently, they do not reflect accrued assets and liabilities of substantial amounts. In view of the foregoing, we cannot express an opinion on the statements as a whole.

The Comptroller in the Federal Government

By X. Bender Tansill, C.P.A.

The term "comptroller" has been used in Federal Government circles for a great many years. The statute which created the Treasury Department (Act of September 2, 1789—1 Stat. 65) originated the office of the Comptroller of the Treasury Department. In the succeeding years other governmental comptrollerships were established, although the function of the particular comptroller varied from agency to agency.

In the recent past both "comptrollers" and "controllers" have been set up in Government agencies. The post of "comptroller" has been established in the Tennessee Valley Authority, Federal Housing Administration, General Services Administration, Post Office Department, The Panama Canal, The American Red Cross, the International Monetary Fund, the Home Owner's Loan Corporation and the Federal Savings and Loan Insurance Corporation. "Controllers" have been appointed in the Bonneville Power Administration (Interior Department), Commodity Credit Corporation (Agriculture Department), Atomic Energy Commission, Economic Cooperation Administration, Reconstruction Finance Corporation and the Federal National Mortgage Association.[1]

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He was formerly associated with several national public accounting firms, as well as with some large corporate enterprises. During World War II he was a Commander in the Navy, in charge of its Cost Inspection Service in Detroit, Michigan.

Since returning to government service, he has been a Special Assistant with the Office of the Comptroller of the Army. His work is chiefly in the field of accounting policy for the Department of the Army.

The Department of the Air Force was the first military activity to have a "comptroller." The Department of the Army soon followed suit. The first comptrollerships in these departments, which were administrative appointments, paved the way for general acceptance of the provisions of Title IV of Public Law 216, 81st Congress, otherwise known as the "National Security Act Amendments of 1949." This Act provided for a Comptroller for the Department of Defense and Comptrollers and Deputy Comptrollers for the three military departments. A statutory existence is now enjoyed by the departmental comptrollers in the National Military Establishment.

Not only did Title IV of Public Law 216 give legislative approval to the comptroller function in the Defense Establishment; for the first time in the Federal Government the function of comptroller was raised to the dignity of Secretaryship level. Sec. 401 (a) of this law states:

> "There is hereby established in the Department of Defense the Comptroller of the Department of Defense, who shall be one of the Assistant Secretaries of Defense."

Reason for the Present Interest in Comptroller Function in Government

The present interest in the function of "comptroller" in Government stems from recommendations of the Accounting Policy Committee which formed a part of the Task Force on Fiscal, Budgeting, and Accounting Activities of the Commission on Organization of the Executive Branch of the Government (more commonly known as the

[1] Congressional Directory, January 1950, Government Ptg. Off., Wash., D. C.

Hoover Commission). These recommendations, in part, were:

"(a) That each department and other establishment have a controller professionally qualified to discharge the duties of his office.

"(b) That the controller function not only as the accounting officer of his organization but also as its budget officer. (This is aimed at the present lack of coordination between accounting and budgeting.)

"(c) That the controller be given a permanent appointment, subject of course, to satisfactory conduct and performance of his duties."

The Transition of the Function of Comptroller

Originally the Comptroller in the Federal Government was one who controlled fiscal matters, that is, the cash aspects of Government. With the advent of the Office of the Comptroller General of the United States, the audit function came to the fore. In line with modern thinking, the controller's role in industry is being borrowed, to a large extent, by government. Save for the question of taxation, the governmental comptroller has duties and responsibilities which practically parallel those of his namesake in business. In the Army, for example, the Comptroller has the whole fiscal responsibility—budget, finance, audit,—as well as the functions of management engineering and progress and statistical reporting.

The Role of the Comptroller of the Army

The Army Comptroller, from the time that office was created by Secretary Royall on January 2, 1948, has functioned as a member of the Army's top management team. From the beginning he has had the responsibility of formulating, coordinating and supervising "those matters pertaining to budget, fiscal, statistical, and management engineering activities of the Department of the Army." During the latter part of 1948 he acquired the further responsibilities for finance and audit.

On August 10, 1949, the Army Comptroller became Comptroller of the Army by statute. Sec. 402 (b) of Public Law 216 (81st Congress) provides in part that:

"There is hereby established in each of the three military departments a Comptroller of the Army, a Comptroller of the Navy, or a Comptroller of the Air Force, as appropriate in the department concerned. There shall, in each military department, also be a Deputy Comptroller. Subject to the authority of the respective departmental Secretaries, the Comptrollers of the military departments shall be responsible for all budgeting, accounting, progress and statistical reporting, and internal audit in their respective departments and for the administrative organization structure and managerial procedures relating thereto.***"

In order to implement the provisions of Section 402 of the National Security Act of 1947, as amended by the National Security Act Amendments of 1949 (Public Law 216, 81st Congress), Department of the Army Circular No. 109, dated 15 October 1949, was issued. Paragraph 2(b) of this circular contains a significant interpretation of a portion of the role of the Comptroller of the Army. It states that:

"The Comptroller of the Army shall be under the direction and supervision of, and directly responsible to, the Secretary of the Army. He shall have concurrent responsibility to the Chief of Staff. His relations to the Chief of Staff and Vice Chief of Staff shall correspond to the relations of a Deputy Chief of Staff to those officers, and, within his field, he shall have the authority of a Deputy Chief of Staff."

More recently the Secretary of the Army has delegated the responsibility for supervision over the affairs of The Comptroller of the Army to Assistant Secretary of the Army.

The Governmental Comptrollers' Immediate Objective

Comptrollers within the Federal Government are faced with the very difficult task of modernizing Federal accounting. In accomplishing this change those features of control embodied in appropriation and fund accounting must be retained and at the

same time management must be furnished with the tools it requires to bring about a proper utilization of men, money and material.

The most difficult immediate mission for the Comptroller is the transition from the cash basis, otherwise known as the obligation and expenditure basis, to the accrual or use basis of accounting. The serious difficulties with the obligation and expenditure basis are first, that there has not been a separation in the past between operating and capital costs; and second, that inventories have not been ascertained in dollar values in order that operating results might be ascertained. Moreover, most fiscal periods differ as between the period of obligation and the period of expenditure and as a result no clearly defined accounting period is possible.

In connection with this situation, the Hoover Commission has this to say:

> "There are serious weaknesses in the internal operations of the Federal Government in the fiscal field. These weaknesses penetrate into the heart of every governmental transaction. The President's budget, as submitted to the Congress annually, does not indicate accurately what the costs of each activity will be over the coming year; and the Government's accounting system, outmoded and cumbersome, does not indicate what was accomplished with the money spent in the past year. * * * The time has come when the budgeting and accounting system of the Federal Government must be modernized. Unless this is done, the Congress, the Executive branch, and the public will be unable intelligently to judge the wisdom of the proposed expenditures and the effectiveness of past expenditures."

Concerning budgeting and accounting in the Federal Government the report states further:

> "Present budgeting and accounting procedures confuse the Congress and the public and make effective administration almost impossible of attainment. With this unfortunate situation in mind, this Commission proposes a radical revision in the Federal Government's budgetary presentation and in its methods of accounting for past expenditures. The new structure we propose is intended to tell the Congress and the public two things:
>
> (1) ON BUDGETING: What is the money wanted for?
>
> (2) ON ACCOUNTING: What do the taxpayers get for it?
>
> These two questions lie at the root of any fiscal system. * * * Budgeting and accounting go hand in hand. * * *"

These observations set the stage for the Commission's Recommendation No. 1, that of a "performance budget." The performance budget is defined as a "budget based upon functions, activities, and projects."

The paramount task confronting comptrollers in Government is, therefore, the wedding of accounting and budgeting in such a manner as to produce an understandable "performance budget." This necessitates the adapting of appropriation and fund accounting to the accrual basis of accounting, that is, replacing "expenditure and/or disbursement accounting" with "expense accounting."

At the present time there are as many opinions regarding what a "performance budget" is as there are accountants and budget experts in the Government. Everyone has his own theory. However, there is beginning to emerge some semblance of what is required in this respect. The Hoover Commission stated that it wanted a "performance budget" which would "focus attention upon the general character and relative importance of the work to be done, or upon the service to be rendered, rather than upon the things to be acquired," such as personal services, materials and supplies, equipment, property, contractual services, and so on. The important thing in budgeting is the "work or the service to be accomplished, and what that work or service will cost." Attention is centered on the function or activity in performance budgeting, not on lists of employees or authorizations of purchases.

One of the first agencies in Government to adopt the "performance" type budget was the Atomic Energy Commission. In its presentation of the budget for this year, the activity breakdown and detailed justifications are "based on accrued costs, reconciled in *total* to obligations" for each year by

showing increases or decreases in inventories, other items of working capital and unliquidated obligations, as

> "accrued costs plus increases or minus decreases in inventories, working capital and unliquidated obligations equals obligations."

There is no breakdown of obligations by activity or program class or as between reimbursable and direct obligations.

On the 12th day of September just past, the President signed the "Budget and Accounting Procedures Act of 1950." This act is the first piece of legislation in nearly thirty years to require the reorganization of accounting throughout the Government. The Comptroller General has been retained as the principal accountant in the Federal Service—in this instance the recommendation of the Hoover Commission to appoint an Accountant General within the Executive Branch of the Government was disregarded by Congress. An interesting aspect of the new law is the fact that this Act authorizes but does not require a "performance" type budget. However, Public Law 216, requiring performance type budgets in the Department of Defense and the military departments, is still in effect.

One of the most important changes in Governmental accounting which will be brought about by the "Budget and Accounting Procedures Act of 1950" is embodied in Section 116. Because of its importance it is quoted herewith:

> "The Comptroller General is authorized to discontinue the maintenance in the General Accounting Office of appropriation, expenditure, limitation, receipt, and personal ledger accounts when in his opinion the accounting systems and internal control of the executive, legislative, and judicial agencies are sufficient to enable him to perform properly the functions to which such accounts relate."

This means that the Comptroller General is authorized to discontinue maintaining his own accounts when he believes agency systems are adequate.

Another important change is contained in Section 117 which directs the General Accounting Office to audit financial transactions of agencies, with due regard "to generally accepted principles of auditing, including consideration of the effectiveness of accounting organizations and systems, internal audit and control, and related administrative practices of the respective agencies." This section also authorizes the Comptroller General to make such audits at field offices of the various agencies, (site audits).

In conclusion, it might be stated that there has been a definite awakening within Government to improve its budgeting and accounting systems. In the past accounting has been of the "single entry" variety—the cash-book phase. Appropriation and fund accounting stress the accounting for cash and the limitations placed upon expenditures. To see that the appropriation language is complied with and that monies appropriated have been spent in accordance with the law required the services of lawyers rather than accountants. However, Congress now recognizes the necessity of following through to find out what is accomplished with the monies spent. Information and reports dealing with the performance of functions and the conduct of activities can be obtained only by using principles founded on good accounting. It is the accountant's task to modernize the fiscal side of the activities in the Federal Government.

New York State Tax Forum

Conducted by BENJAMIN HARROW, C.P.A.

Franchise Tax Payments—Article 9A

A CALENDAR year corporation must file its return by May 15th following the close of the year. A report on the basis of a fiscal year ending after July 1, 1950, is due within 3½ months after the close of the fiscal year. The latter requirement is based upon a 1950 amendment to section 211.1 of Article 9A and became effective February 21, 1950.

The law provides for payment of the tax in two installments, one-half being payable with the filing of the return. For fiscal year corporations the second installment is payable by the first day of the eighth month after the close of the fiscal year (section 213.1).

For calendar year corporations the due date of the second installment may be one of three dates. If a notice of the tax due has been given dated October 16th or prior thereto, the payment is due on November 15th. If the notice is dated after October 16th, the payment is due within 30 days of the notice. If no notice is given, the payment is due no later than January 15th. Non-payment of the second installment by January 15th results in penalties.

The confusion with respect to the due date of the second installment would seem to be unnecessary. Perhaps the simplest way to correct an unhappy situation is to make the due date the same for all corporations, namely the first day of the eighth month following the close of the year, calendar or fiscal. To be sure, the effect of such a requirement would be to advance the due date for calendar year corporations by 3½ months, but at the same time it would eliminate a discrimination that calendar year corporations enjoy, as against fiscal year corporations since advancing the due date of payments is in line with the principle adopted in the Revenue Act of 1950 for corporations.

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The Taxable Year—Article 16

Several members of the Income Tax Bureau take issue with my statement in the November, 1950, issue of the New York State Tax Clinic[1] that the dissolution of a fiscal year taxpayer, individual or partnership, closes the taxable year of the taxpayer. They contend that the taxable year does not end with the expiration of the twelve month period, even though the taxpayer is not in existence for part of that period.

Presumably the Income Tax Bureau relies on the provision in section 358(1) of the Tax Law that a fiscal year means an accounting period of twelve months. The regulations (Art.

[1] Page 689.

12) provides that income must be computed with respect to a fixed period. "*Usually* (italics ours) that period is twelve months. . . ."

Under the federal law returns for periods of less than twelve months are recognized. That is particularly true where the taxpayer has not been in existence for a full accounting period (section 47(g), I.R.C.). Thus, a corporation that liquidates and dissolves and goes out of existence before the close of a taxable year files a return for a short period and is not required to place its income for the short period on an annual basis. A corporation that commences business may adopt a fiscal year without permission of the Commissioner and its first return may be a short period of less than twelve months.

In the case of the death of a taxpayer, the law (sec. 358.1) provides that in computing net income "for the taxable period in which falls the date of his death" the taxpayer shall include amounts accrued up to the date of death, even if the taxpayer has been reporting on a cash basis. There is, of course, the option to treat such accrued income as taxable to the executor or beneficiary who acquires the right to receive the income. There would appear to be an implication in the law that the taxable year of a decedent ends with his death. It is true that in determining the personal exemption on the decedent's final return, an exemption for twelve full months is allowed, the exemption for the period after death being at the rate of $1,000, the exemption for a single person (Art. 209).

Suppose an individual taxpayer who had been reporting his income on a fiscal year basis ending June 30th died on November 1, 1950. Would the final return cover the period from July 1, 1950 to June 30, 1951, or would it be for the period from July 1, 1950 to October 31, 1950? If the taxable year must be a period of twelve months then the basis of the tax would be the period ending June 30, 1951.

That would seem to be the contention of the Income Tax Bureau. No return would then be due until October 15, 1951. The issue has many implications, the chief one being the applicable rates, 1951 or 1950.

Capital Assets

The sale of capital assets receives special treatment under the income tax law. It is therefore important to know what is meant by capital assets. To the accountant, the term for years has had a definite meaning, namely, property acquired through an expenditure of capital, the value of which will extend beyond a current period. Our present interest is in such assets as buildings, machinery, furniture and fixtures. The accountant's concept however is not the same as the income tax concept. The definition of capital assets in section 350.12 starts with the all inclusive statement that the words mean "property held by the taxpayer (whether or not connected with his trade or business)." This is followed by a statement of what is not included in the meaning of capital assets, and among the latter items are land used in a trade or business, and depreciable property used in a trade or business. To classify such assets as non-capital seems incongruous to the accountant.

One of our members submits a situation that highlights this difference in the concept of capital assets. A taxpayer had operated a rooming house. Over the years, expenditures had been made for chairs, tables, beds, and other furniture items. The taxpayer sold his business but retained the major portion of the furniture. These he later disposed of at a profit, which he reported as capital gain. The State Tax Commission taxed the gain as ordinary income on the ground that depreciable assets used in a trade or business are not capital assets. In our opinion, at the time the property was disposed of, it was not used in the trade or business and therefore could qualify as property held by the taxpayer, whether or not

connected with a trade or business. Had the property been sold when it was used in the trade or business, the contention of the Tax Commission would be correct.

One further point that adds to the accountant's confusion should be mentioned. Under the Internal Revenue Code (section 117 J) a gain on the sale of depreciable assets used in a trade or business may be treated as a capital gain if the property had been held for more than six months, whereas a loss on such a sale may be treated as an ordinary loss, fully deductible. New York State does not have a similar provision. The regulations under the Internal Revenue Code (section 29.117-1) provides that the term "property used in the trade or business" means property so used at the time of the sale. In spite of this regulation a decision of the Tax Court is at variance with it.[2] This Court held that there had not been an abandonment of property but a preservation of it for possible further use, "or at least for sale for use by others in its original capacity."

Real Estate Corporation Controlled by a Business Corporation

The New York legislature in 1948 amended section 211.4, making it clear that a real estate corporation shall become taxable under Art. 9A whenever substantially all the stock of the real estate corporation is owned or controlled directly or indirectly by a business corporation, or whenever the stock of both companies is controlled by the same interests and, in addition, any material part of the property of the real estate corporation is used in the conduct of its business by the business corporation.

Upon a change in classification of the real estate corporation, the tax under Art. 9 is prorated. This provision became effective on July 1, 1950. There had always been some question as to just when a change in classification becomes effective. There has just been released an official reissue of the Article 9A regulations.[3] These make it clear that if the provisions of section 211.4 become applicable, the real estate corporation immediately ceases to be taxable as such and immediately becomes subject to tax under Article 9A (Reg. Art. 160).

It should also be remembered that upon a change in classification the real estate corporation becomes subject to the 2% tax on any dividends distributed and not theretofore used as a basis of this tax and, in addition, it is taxed upon the excess of the actual net worth of the corporation over the actual paid in capital.

The Deduction of the Franchise Tax from Entire Net Income

In computing entire net income, the starting point is federal net income. One of the adjustments to be made to federal net income is the deduction of the New York franchise tax. For example, for 1950 calendar year corporations, the next franchise tax return (1951) is due on May 15, 1951. The 1950 federal return on an accrual basis will contain a deduction for the franchise tax payable in 1951. This accrual must be added back to federal income in determining the franchise tax. However, the franchise tax that was based upon the year 1949 is deductible.

This method of allowing a deduction for the franchise tax requires a chain of adjustments whenever entire net income is changed whether because of a federal change in net income or because of a change made by the Tax Commission directly. The revised regulations (Art. 600) give an example of the several adjustments that must be made. Suppose the Tax Commission has assessed an additional tax for the calendar year 1947. This will require a recomputation of entire net income for the base year 1948. The increase in

[2] *Wilson Line, Inc.* 8 T.C. 394 (A) 1947.
[3] November 15, 1950.

tax for the 1947 year results in a decrease in entire net income for the year 1948 and a decrease in the franchise tax for 1948. This results in a reduction of the deduction from entire net income claimed in the report for the year 1949, with a resulting increase in the franchise tax for 1949. Similar adjustments must then be made in reports for subsequent years alternately increasing and decreasing the deduction claimed in the respective years. This is an awkward adjustment, administratively unsound. It should be possible to simplify this process, probably through a different provision for taking the deduction for franchise taxes.

Entire Net Income—Net Operating Loss

One of our members suggests that section 208 (9) (b) be amended to allow a deduction for net operating losses in determining entire net income. He argues that new corporations may incur losses in the earlier years of operation and, when they reach a good level of income, the franchise tax paid on the income basis is inordinately high when compared with the accumulated earnings.

There undoubtedly is some merit to this suggestion but, from the point of view of raising revenue through a franchise tax on corporations, it would present insuperable obstacles. Under an income tax law, such as the Internal Revenue Code, it is possible to tax corporations on the basis of a five-year cycle or, since the Revenue Act of 1950, on a seven-year cycle. The revenue raising problems of the state make it necessary to depend upon a certain minimum revenue each year. That is why entire net income is only one basis for the franchise tax. If a corporation sustains a loss in any year the franchise tax may be determined on the basis of business and investment capital (the one mill tax). In New York there is no income tax as such on corporations. The corporation is taxed upon its right to do business as a corporation, and it exercises this right whether it makes a profit or sustains a loss. To allow a deduction for a net operating loss carryover would cut seriously into the state's revenues, and would necessitate an increase in the franchise tax rate. Even if a net operating loss carryover were allowed on some modified basis, the idea of a net operating loss carry back would create serious administrative difficulties.

Franchise Tax—Salary Elimination Basis

One of our members would like to eliminate the alternative method of computing the franchise tax based upon entire net income plus salaries to elected and appointed officers and to stockholders owning in excess of 5% of the issued stock. He does not see any merit in this basis. He argues that if officers' salaries are reasonable, they should be allowed as a deduction in full in arriving at net income. Actually the practical effect of this computation is to subject to franchise tax a portion of the officers' salaries and at the same time those very salaries are subjected to income tax in the hands of the officers.

This basis was originally designed to prevent evasion of the tax through the distribution of profits in the guise of salaries. After its first enactment in 1929, it was thought that this method of dealing with excessive salaries would avoid numerous controversies dealing with unreasonable salaries. There is no doubt that the Tax Commission has succeeded in eliminating about 90% of controversies on the disallowances of salaries on the ground that the Commission believes them to be unreasonable. Nevertheless, the Commission continues to question the reasonableness of salary deductions where a greater tax will result from such disallowance.

Form 3 C.T. does not provide a schedule for the computation of the tax under this so-called salary elimina-

tion basis. The Tax Commission generally makes this computation, although there is no objection to the corporation itself making the computation and attaching it to the return as a rider. This might be advisable since the corporation may wish to accrue the actual tax on the federal income tax return. When the current franchise tax return was designed in 1945, there was no room for including a schedule for this computation and the problem was solved by omitting it entirely and leaving it to the Commission to make the computation.

Non-resident Income Tax Returns—Deductions

A non-resident is taxed only upon income from New York sources. Deductions from gross income are allowed only if they are connected with taxable income from sources within the state. One of our members thinks this is inequitable, particularly in a case where the sole income of the non-resident is from New York sources. This member suggests that a non-resident should be permitted to deduct at least a portion of the deductions ordinarily permitted to a resident, such as real estate taxes, interest on a mortgage, medical expenses, and other personal expenditures. He would apportion these deductions on the basis of gross income within and outside the state.

When the first income tax law was enacted, a non-resident raised this question by arguing that it was unconstitutional to discriminate against him by allowing deductions only when they were connected with income arising within the state. The U. S. Supreme Court held such discrimination to be constitutional.[4] Since January 1, 1947, of course a non-resident taxpayer may claim the optional deduction of 10% of gross income or $500, whichever is less, in lieu of all deductions otherwise allowable. This is not very helpful to a non-resident who is receiving income from a business, but it gives a little relief to a taxpayer who has income from New York sources, but no deductions connected with the income.

Capital Gains and Losses

One of our members makes the suggestion that a deduction for a net capital loss should be permitted against ordinary income to the extent of $1000, the same as under the federal law. The taxation of capital gains and losses has always posed a problem. Congress has wrestled with it for years and has not yet solved the problem to the satisfaction of all taxpayers.

There is fairly unanimous opinion that this type of income should not be taxed as heavily as ordinary recurring income, although there are dissenting views. Some taxpayers point to the British Income Tax Law which does not tax capital gains unless they are connected with the carrying on of business. Others feel that if a distinction should be drawn between different kinds of income, preferred treatment should be given to earned income rather than capital gains. At the present time capital gains are not taxed as heavily as ordinary income, principally because the gain must be taxed in the year of realization, whereas the economic appreciation in the value of capital assets may have taken place over a much longer period of time. Under the federal law there is a further recognition of this difference between economic income and taxable income, in the distinction made between short-term gains and long-term gains.

Congress long ago also felt that if there is to be a limitation of the tax on capital gains, there should be a limitation on the deduction of a capital loss. Many considerations determined the present basis for the allowance of any deduction for a net capital loss, the chief ones being the necessity for not disturbing the steady flow of revenue and a desire at the same time to recognize the fact that a taxpayer who has

[4] *Travis* v. *Yale & Towne Mfg. Co.,* (1920) 252 U.S. 60.

sustained an economic loss should receive some tax relief.

In 1938, New York set up the present method of taxing capital gains. It recognized the fact that such income should not be taxed as heavily as ordinary income by taxing capital gains separately at one-half the rates applicable to ordinary income. To simplify its own administrative problem, it eliminated any distinction between short-term and long-term gains. In limiting the deduction for capital losses, it provided, first, that capital losses could be offset only against capital gains. Second, it provided that a net capital loss could be carried over for five additional years until it could be absorbed by capital gains in those years. This provision was put into the law in 1943, but was made retroactive to January 1, 1942. Other than the right to carry over a net capital loss, no further deduction is permitted.

To allow a deduction against ordinary income up to $1,000 would, of course, afford some relief to taxpayers who have suffered a serious economic loss. The major consideration is the extent to which such a provision would offset adversely the revenue of the state. At this particular time it is unlikely that the State Tax Commission would approve a provision to reduce revenue. There have in fact been indications that this year the Governor may ask for an increase in the income tax rate.

The Statute of Limitations—Franchise Tax

The Tax Commission has five years from the date a report is filed (not five years from the due date) within which to examine the report or, as the law puts it, audit and state an account (section 212.1). Within the same five year period it may reexamine the report or reaudit and restate the account (section 212.2). If the audit results in an additional tax, a notice of assessment is usually mailed to the taxpayer. The date of the notice is important because the taxpayer has two years from that date within which to file an application for revision on Form 7 CT. Neither the date of receipt of the notice nor the date of payment of the assessment offsets the two-year time limitation. If the notice of assessment is based upon a reaudit, the taxpayer has only one year from the date of the notice within which to file a claim for revision.

If the Commission does not audit the return within five years, the return is generally final for all purposes. There are some exceptions to this provision. One relates to the case where no return has been filed. The second relates to a return that is believed to be willfully false or fraudulent. In those cases, there is no time limitation placed upon the Tax Commission for auditing or reauditing the taxpayer's account.

The third exception relates to changes made in net income by the Commissioner of Internal Revenue, or other officer, or authority. In such a case the Commission may assess an additional franchise tax due as a result of such change in entire net income, even though the five-year period has elapsed. However, in assessing any additional tax, the Commission may not change the allocation of income or capital determined on any original assessment made by it (section 212.4).

A change in net income made by the federal government is required to be reported to the Commission within 90 days after a final determination. The change may also be reported by a corporation on its next return, presumably if this is due before the 90 day period. If the corporation files an amended income tax return with the federal government, it is required to file an amended franchise tax report with the Tax Commission within 90 days (section 211.3).

The question has been asked frequently whether the Tax Commission, in making an additional assessment based upon changes in federal net in-

come, may reopen other items in the return. Within the five year period discussed above, it is our opinion that the Commission has the power to do this, although generally it does not. There appears to be some authority in several cases that only changes made by the federal government may be considered upon a reaudit.[5] In both cases it was the taxpayer who wanted to open up the entire return, but the decisions would probably be applicable to the Tax Commission as well.

Treatment of Blocked Income—Franchise Tax

Under the federal law, a taxpayer reporting income on the accrual basis need not include accrued income from a foreign country that is not available because of restrictions on the movement of currency. Such income and related deductions may be deferred until such time as the income is made available. States generally have provided similar relief under state tax laws. New York has not yet issued any regulation with respect to the treatment of blocked income.

The problem is not an easy one for the Tax Commission. Deferring income from one year to another may not be serious in itself if the tax rate remains the same and the corporation is taxable in both years on the basis of entire net income. But the deferred income may affect the allocation formula, and that may distort the results to the detriment of the corporation or the state.

Many suggestions have been made for an equitable solution of this problem. One plan would be to give the corporation the option of including blocked income in the year in which it accrues, but this has the effect of requiring a corporation to pay taxes on unavailable income. Another plan is to report deferrable income in the year in which the income is reported for federal tax purposes, with the further provision that the franchise tax on such income should not be greater than it would have been had it been included in the year in which it accrued. Under this plan it is really the tax that is deferred, and not the income. One plan for the allocation of deferrable income is to eliminate foreign income both from the numerator and the denominator of the receipts factor. Another plan is to include the deferrable income in the year it accrued, merely to determine the allocation fraction for that year, and then to apply that allocation percentage separately to the deferrable income in the year in which it is to be taxed.

In our opinion the simplest method would be merely to defer the tax on the foreign income until it is unblocked. To safeguard the revenue the Tax Commission should be put on notice that the tax on blocked income is being deferred. Because of the uncertainty as to the year in which the tax will be paid, the Commission would probably require the filing of a bond to guarantee payment.

[5] *People ex rel. Jacob Dall & Sons, Inc., et al.* v. *Graves et al.,* (1939) 257 App. Div. 481; appeal denied.
People ex rel. International Salt Co., Inc. v. *Graves,* (1935) 267 N. Y. 149.

Accounting at the S. E. C.

Conducted by LOUIS H. RAPPAPORT, C.P.A.

Regulation S-X Revised

THE long expected revision of Regulation S-X was released by the Securities and Exchange Commission on December 20, 1950. As most accountants know, this is the principal accounting regulation of the SEC in connection with several of the statutes administered by it. Although there have been amendments and changes in the regulation from time to time, this is the first comprehensive amendment since the regulation was promulgated in 1940.

The revised regulation is effective with respect to financial statements for any fiscal year ending on or after December 31, 1950, filed with the SEC as a part of any registration statement, application or report.

Income statement. The principal new requirements relate to the income statement. Rule 5-03 has been revised as follows:

> Rule 5-03. Profit and Loss or Income Statements.
>
> Except as otherwise permitted by the Commission, the profit and loss or income statements filed for persons to whom this article is applicable shall comply with the provisions of this rule.
>
> (a) All items of profit and loss given recognition in the accounts during the period covered by the profit and loss or income statements shall be included.
>
> (b) Only items entering into the determination of net income or loss may be included.

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In addition, two new captions have been added to the prescribed form of income statement immediately after net income so that the revised income statement concludes as follows:

> 16. Net income or loss.
>
> 17. Special items.—State separately and describe each item of profit and loss given recognition in the accounts, included herein pursuant to rule 5-03(a), and not included in the determination of net income or loss (Item 16).
>
> 18. Net income or loss and special items.

In some annual reports to stockholders, charges and credits to earned surplus have been made pursuant to Accounting Research Bulletin No. 32. However, when the same treatment was followed in statements filed with the SEC, its staff has consistently taken exception to the items entered in earned surplus and has required that the financial statements be amended to include these amounts in the determination of net income. Where this has happened, the accountant who gave a clean certificate covering the statements in the stockholders' report has had to issue a qualified certificate as to the amended statement filed by a registrant to meet the SEC's views.

The adoption of Rule 5-03(a) and captions 17 and 18 referred to above may be taken as an indication that the SEC now agrees that certain profit and loss items recognized during a period should not enter into the determination of net income. The effect is that profit and loss items entered in earned surplus in reports to stockholders in accordance with Accounting Research Bulletin No. 32 should be shown as special items (caption 17) in statements filed with the SEC. Since the difference between the two sets of statements would be one of form and

not substance (net income not being affected), I would expect the same certificate would apply to both statements.

It is not to be supposed that this revision will eliminate all conflicts between the SEC and registrants with respect to the position in the statements of extraordinary charges and credits which are carried to earned surplus in published reports. Where such items are included in caption 17 as special items, the staff of the SEC may take the position that these items should enter into the computation of net income and should be added or deducted before arriving at caption 16 (net income).

It will be observed that the treatment of surplus charges and credits as "special items" conflicts with the application of Accounting Research Bulletin No. 35 in certain circumstances. That bulletin, in effect, recommends that the net income for the period be shown without being followed by items that have nothing to do with the determination of net income. I understand that this bulletin probably will be revised so as to avoid the present conflict.

Where financial statements are prepared in accordance with the requirements of Regulation S-X as now revised, it would appear that the earned surplus account would show only these captions:

Balance at beginning of period

Net income or loss (and special items, if appropriate)

Dividends

Appropriations to or restorations from surplus reserves

Write-offs of intangibles not being amortized through income and as to which there has been no decline in value

Balance at close of period.

The language of Rule 5-03(b) is unfortunate. It was intended to exclude from income statements items such as appropriations to and restoration from surplus reserves. As written, it seems to exclude the special items contemplated to be included in caption 17, but it was not so intended.

Application of Regulation S-X. Regulation S-X governs the form and content of financial statements required to be filed as part of registration statements, applications and reports listed in Rule 1-01. The rule has been revised to make it clear that the regulation *together with the Accounting Series Releases* state the requirements. It is now more important than ever to have a complete file of these releases.

Definitions. A number of new definitions have been added to the regulation; other definitions have been revised; some have been eliminated. All of the additions and revisions have been made with the purpose of making them consistent with the SEC's definitions in other regulations. For example, the definition of "material" has been added, and "significant subsidiary" has been revised. Both terms are also defined in Regulation X-12B which relates to applications and reports under the 1934 Act. Under the revised meaning attributed to "significant subsidiary," the measure of significance was raised from 5% to 15%.

Accountant's Independence. Rule 2-01, dealing with qualifications of accountants, has been revised slightly. In determining whether an accountant is, in fact, independent, the SEC will consider not only the relationship between the accountant and the corporation whose statements he certifies, but will also consider the relationship between the accountant and any affiliate of the corporation.

Accountants' certificates. The requirements governing accountants' certificates have been revised in some respects.

Where an auditing procedure generally recognized as normal, or deemed necessary by the accountant under the circumstances of a particular case, has been omitted, the accountant must designate what procedures were omitted; he must also state the reason for their omission.

The new regulation omits the paragraph in the old regulation which dealt with the accountants' review and consideration of his client's system of internal check and control. Presumably this omission was made because such review is now a requirement of generally accepted auditing standards. (See Statements on Auditing Procedure No. 24.)

Revision has also been made in the requirements as to opinions to be expressed in accountants' certificates. The accountant is now required to state clearly, among other things, his opinion "as to any *material* changes in accounting principles or practices or *method of applying the accounting principles or practices*" (the italicized portion is new).

A new rule (designated 2-05) has been adopted dealing with certification where the over-all examination is made by more than one accountant. This rule merely codifies what has up to now been an administrative requirement.

Unrequired or inapplicable statements and schedules. The old regulation contained a provision which required a listing of omitted schedules and the reasons for their omission. As used in the amended regulation the term "financial statements" includes all the supporting schedules. The new regulation calls (Rule 3-03(c)) for an indication of *all* financial statements omitted and the reasons for their omission in the list of financial statements required by the applicable form. The result is that the applicable form must now list all financial statements omitted as well as schedules omitted and the reasons for their omission.

Changes in accounting principles and practices and retroactive adjustments of accounts. Rule 3-07 as revised is materially different from the old rule. The new rule is as follows:

(a) Any change in accounting principle or practice, *or in the method of applying any accounting principle or practice*, made during any period for which financial statements are filed which affects comparability of such financial statements with those of prior *or future* periods, and the effect thereof upon the net income for each period for which financial statements are filed, shall be disclosed in a note to the appropriate financial statement. (emphasis supplied)

(b) Any material retroactive adjustment made during any period for which financial statements are filed, and the effect thereof upon net income of prior periods shall be disclosed in a note to the appropriate financial statement.

Valuation and qualifying reserves. The new rule (3-11) requires all valuation and qualifying reserves to be deducted from the assets to which they apply. The exception which previously existed in relation to depreciation or retirement reserves of public utilities has been deleted. It is not known whether the SEC intends to apply the revised rule with respect to public utilities, but the indications are that they do.

Under Section 13(b) of the 1934 Act the SEC is empowered to prescribe the form of reports to be filed by listed companies, but the Commission's requirements may not be inconsistent with those imposed by any other Federal commission in respect of the same subject matter. The Federal Power Commission, at the present time, includes depreciation reserves among the liabilities in its uniform systems of accounts, but in its annual report form, the depreciation reserves are required to be deducted from the plant account.

Commitments. A new rule has been adopted (Rule 3-18) requiring disclosure of material commitments for the acquisition of permanent investments and fixed assets and for the purchase, repurchase, construction, or rental of assets under long-term leases. Where the rentals under long-term leases are material, disclosure must be made along the lines contemplated by Accounting Research Bulletin No. 37.

Intercompany profits and losses. Rule 3-18(b) in the old regulation dealt with intercompany profits and

losses in inventory. The new rule (designated 3-19(b)) is broader; it requires disclosure of the effect upon any balance sheet item of profits and losses resulting from transactions with affiliates. If the amount is incapable of accurate determination, an estimate must be made or explanation given.

Defaults. The old regulation required (Rule 3-18(c)) disclosure of any default in principal, interest, sinking fund, or redemption provisions with respect to any issue of securities. The new regulation calls (Rule 3-19(c)) for all this and, in addition, defaults affecting credit agreements, and any breach of covenant of a related indenture or agreement. The last-mentioned requirement may give accountants some concern, since in some cases the breach of a covenant may not be financial in nature and hence may not be one that would ordinarily be disclosed in financial statements.

Pension and retirement plans. A new rule (3-19(e)) requires a note dealing with pension and retirement plans:

> (1) A brief description of the essential provisions of any employee pension or retirement plan shall be given.
>
> (2) The estimated annual cost of the plan shall be stated.
>
> (3) If a plan has not been funded or otherwise provided for, the estimated amount that would be necessary to fund or otherwise provide for the past service cost of the plan shall be disclosed.

Dividend restrictions. Another new rule (3-19(f)) calls for a description of any restrictions which limit the availability of surplus for dividend purposes, with an indication of the source of the restriction, the pertinent provisions, and where appropriate and determinable, the amount of surplus so restricted.

Depreciation policy. The requirements regarding the note which states the depreciation policy are unchanged except that a statement must also be made as to the accounting disposition of profits or losses on sales of fixed assets.

Consolidation of foreign subsidiaries. A new rule (designated 4-02(c)) has been adopted relating to consolidation of foreign subsidiaries. The rule is as follows:

> (c) Consolidation of foreign subsidiaries.—Due consideration shall be given to the propriety of consolidating with domestic corporations foreign subsidiaries whose operations are effected in terms of restricted foreign currencies. If consolidated, disclosure should be made as to the effect, insofar as this can be reasonably determined, of foreign exchange restrictions upon the consolidated financial position and operating results of the registrant and its subsidiaries.

Reconciliation of investments and equities in subsidiaries. Rule 4-05(b) in the old regulation called for a statement of the difference between the investment in unconsolidated subsidiaries for which statements are filed and the equity therein. This rule has been amended by adding a similar requirement for "fifty per cent owned persons" (as defined).

Special Requirements for Public Utility Holding Companies. Rule 4-13 of the old regulation has been condensed considerably but, taken with the requirements in Rule 5-02(13) (Fixed Assets), there is no effect on the amount of information to be furnished.

Balance Sheets

Rule 5-02 sets forth the requirements as to balance sheets of companies to which it applies. Such balance sheets must comply with the provisions listed in the revised regulation *except as otherwise permitted by the Commission* (italicized portion is new).

Other current assets. In addition to a separate showing of cash, receivables, inventories, and certain other assets, the old regulation called for a segregation of any other current assets in excess of 5 per cent of total current assets. In the revision this requirement has been raised to 10 per cent of total current assets.

Securities of affiliates. The basis at which investments in securities of affiliates are carried is now required to be stated.

Other investments. The old regulation called for a segregation of:

(a) Securities of affiliates
(b) Indebtedness of affiliates—not current
(c) Other security investments.

In addition, the regulation provided that there be stated separately, by class of investments, any items in excess of 5 per cent of the amount of all assets other than fixed and intangible. In the revision this measure was raised to 10 per cent.

Fixed assets. The new regulation provides for a breakdown if practicable, on the face of the balance sheet, of fixed assets by major classes or functional grouping, together with disclosure of the basis at which carried.

Intangible assets. The revised regulation calls for a statement of the basis at which intangible assets are carried in the balance sheet.

Other assets. In addition to the required classification of assets, the old regulation provided that there be shown separately any item in excess of 5 per cent of the amount of all assets other than fixed and intangible assets. In the revision this amount was raised to 10 per cent.

Other current liabilities. The requirement for showing current liabilities not otherwise classified was raised in the revised regulation from 5 per cent to 10 per cent of total current liabilities.

Long-term debt. The provisions affecting the showing of long-term debt have been amended in important respects. Captions 28 and 30 as revised, follow (Caption 29, Indebtedness to affiliates — not current, was not changed):

28. Bonds, mortgages and similar debt.—State separately here, or in a note referred to herein, each issue or type of obligation and such information as will indicate (a) the general character of each type of debt including the rate of interest; (b) the date of maturity, or if maturing serially, a brief indication of the serial maturities, such as "maturing serially from 1950 to 1960"; (c) the aggregate amount of maturities, and sinking fund requirements, each year for the 5 years following the date of the balance sheet; (d) if the payment of principal or interest is contingent, an appropriate indication of such contingency; (e) a brief indication of priority; and (f) if convertible, the basis.

30. Other long-term debt.—Include under this caption all amounts of long-term debt not provided for under captions 28 and 29, above. State separately (a) total amounts due banks, (b) total amounts due directors, officers, and principal holders of equity securities other than affiliates and (c) other long-term debt, specifying any material item. Indicate whether secured. Show here, or in a note referred to herein, the information required under caption 28.

Other liabilities. As in the case of other asset and liability amounts, the disclosure requirements in respect of "Other liabilities" not otherwise classified were raised from 5 per cent to 10 per cent of liabilities other than long-term debt.

Reserves. Under the amended regulation, the purpose of each reserve, not shown elsewhere, must be clearly indicated.

Capital shares. In respect of convertible shares, the revised regulation requires that the basis of conversion be stated.

Surplus. The old regulation provided that where a company had not in its accounts differentiated the various classes of surplus, then the unsegregated items could be stated in one amount. This provision does not appear in the revised regulation. Presumably the SEC will now require all companies filing with it to make the necessary breakdown or secure its permission to waive the requirement.

Income and Surplus Statements

Reference has already been made to the provisions of Rule 5-03(a) and to captions 16, 17 and 18 of the new income statement. These are the most important provisions of the new regulation. The other changes relating to the content of the income and surplus statements are unimportant.

Notes on Recent New York State Unemployment Insurance Cases

Conducted by Samuel S. Ress

Staff accountants who refuse to travel and leave their jobs for that reason are not entitled to unemployment insurance benefits, according to a decision of the New York State Appeal Board, which reversed a Referee's decision in favor of the accountant.

The facts in Appeal Board Case #23,761-50, decided on November 29, 1950, were:

"Claimant, a semi-senior accountant, filed for benefits on February 22, 1950 ....

"Claimant was employed by a firm of accountants from June 30, 1947, to February 21, 1950, on which date he resigned from his position. His final rate of pay was $280 a month. Because of his position in the firm and the nature of the employer's business, claimant was required to travel extensively on work assignments. During the fall of 1949 he was away from home for 12 consecutive weeks, then remained in the city for two weeks and then again was on a traveling assignment for a period of about three or four weeks. In January, 1950, claimant was on a traveling assignment for two weeks. On February 21, he was advised that his next assignment would require him to travel to Philadelphia, Pennsylvania, for a period of four weeks or more. No arrangement could be made to retain him in employment without traveling. Thereupon, claimant left the job.

"When claimant was hired by the employer he was married. On January 18, 1949, his child was born. His wife objected to his continuous traveling and absence from home. She did not desire to stay at home alone with her child . . . .

"The local office issued an initial determination holding that claimant left his employment, as aforesaid, voluntarily without good cause. The claimant requested a hearing. The referee overruled the initial determination and the Industrial Commissioner appealed to this Board from said decision."

The Appeal Board's opinion stated:

"We are unable to agree with the conclusion reached by the referee. In our opinion, no compelling reason was advanced by claimant to justify his unwillingness to travel, which formed part of his duties according to a contract of hire and which duties he performed for some time prior to, and for upwards of one year after, the birth of his child. His objection to traveling, therefore, seems to us to have been prompted by consideration of personal convenience rather than hardship. Under the circumstances, we must conclude that claimant's voluntary leaving of employment is without good cause."

Farm Worker or Domestic Servant

The New York State Unemployment Insurance Law exempts farm laborers from coverage, but requires that contributions be paid on wages of domestic servants if four or more do-

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Dr. Ress, who has written a number of articles which have appeared in *The New York Certified Public Accountant,* is a member of the Society's Committees on Clothing Manufacturing Accounting and on Labor and Management.

mestics are employed apart from any other employees that may be in the employ of the individual employer's business.

The recent amendments to the Federal Social Security law provide coverage for agricultural workers who are regularly employed by an employer and earn cash wages of at least $50.00 in a calendar quarter. On farms operated for profit, household workers performing services not in the course of the employer's trade or business are considered "agricultural labor" and, in order to be covered, must meet the regularity and cash wage tests for farm workers.

Domestic service in a private home not on a "farm operated for profit" is covered if the cash wages paid in a calendar quarter are $50.00 or more, and the worker is employed on 24 different days during the calendar quarter.

The New York State Unemployment Insurance Appeal Board decision in Case #23,836-50, dated December 7, 1950, clarifies the law in this State for Unemployment Insurance purposes. The employer appealed from the Referee's decision holding that the claimant worked in covered employment. The Appeal Board sustained the referee's decision. The facts were as follows:

"Claimant filed for benefits on August 3, 1949. By initial determination he was declared ineligible because of insufficient earnings in covered employment in the base year, 1948.

"From March, 1947, to July, 1949, claimant was employed by the employer named below on the latter's estate in Suffern, New York. The employer is engaged in the real estate business in New York City. During the period herein, he maintained a large estate in Suffern, New York, consisting of approximately 160 acres. There was maintained on the estate some live stock, consisting of one or two beef steers, approximately 500 chickens, five pigs and two cows. About one and a half acres were set aside for cultivation as a vegetable garden. The employer does not contend that he conducted a farm or that he is exempt from the provisions of the Unemployment Insurance Law for that reason. These agricultural (sic) pursuits were engaged in as a hobby. What was not consumed by the employer's household was distributed to friends, employees, etc. Nothing was sold commercially.

"Claimant was employed primarily to take care of the vegetable garden and the live stock. In addition to claimant, there was employed, commencing with at least May 1, 1948, a nurse for the employer's baby and a couple, consisting of a cook and butler. There was also a laundress who came practically every day and who also did sewing for the household. There were at least 15 days on which four domestics were employed simultaneously, commencing with at least May 1, 1948.

"Claimant was paid cash wages of $160.00 a month and in addition he received a five-room bungalow, rent free. The rental value of this bungalow was $35.00 and in addition claimant received free gas and electricity valued at $5.00 a month.

"Besides caring for the livestock and attending the vegetable garden, claimant mowed the lawn and cleaned the swimming pool on the estate, when necessary. In addition thereto, he drove the employer's automobile when doing errands and performed other chores for and on behalf of the employer. During the winter season, when the premises were not occupied by the employer and his family, claimant acted in the capacity of caretaker."

The Appeal Board stated:

"The referee held that claimant was not engaged in agricultural labor while working for the employer herein.

"It does not appear that the employer's premises were ever used or operated as a farm within the meaning of the Unemployment Insurance Law, Section 511.6. Conceivably, some of the activities sponsored by the employer were of an agricultural nature. However, the extent of such activities and the manner in which they were conducted, can hardly lead to the conclusion that the premises constituted a farm within the purview of the section cited.

"The coupling of domestic servants with agricultural workers, in the same Act, is significant. Agricultural workers are those who are engaged in an enterprise conducted by the employer for his profit. House servants merely contribute to the personal needs and comfort of the employer. Between the two groups are the out-servants, who in strictness do not fall within either class. And yet there is much better reason for excluding gardeners, caretakers and the like, than agricultural workers, for they are not engaged in a commercial enterprise and their services all relate to the home-life.

"Our conclusion, in construing the Act, is

that the place where the services are performed does not determine the nature of the employment. Cooks and house maids are domestic servants, not because they work indoors, but because they serve the needs of the household. Similarly, one who drives an automobile in bringing supplies from market or in disposing of waste materials or who raises vegetables and produce for use on the estate is a domestic servant in the broader sense contemplated by the Act. Growing flowers for the delight and pleasure of the family of the owners is the same kind of service. Where, as here, the grounds though extensive, are maintained as the curtilage to the mansion house and for the comfort and pleasure of the occupants, they who thus minister to the needs of the owners, according to the standard of living established by them, are domestic servants within the purview of the Act."

"* * *

"The precise question here involved has not been before our appellate courts. In *Anderson* vs. *Ueland*, 197 Minn. 518, 267 N.W. 517, 927, however, in construing a similar provision of a Compensation Act, it was held that 'domestic servants' included a gardener or caretaker whose activities were directed toward the care and maintenance of the home.

"We think it clear that 'domestic service' was intended to include services such as were rendered by claimant.

"Upon all the facts and circumstances herein, we are persuaded that the premises in question were not 'a farm' and that the services performed by the claimant, consequently, did not constitute 'agricultural labor' within the meaning of the Law. The services rendered pertained to the employer's country estate, his household and his family and related to the employer's domestic existence. Claimant, therefore, was employed in personal or domestic service. It follows that he worked in covered employment and is entitled to be credited with his earnings as set forth in the schedule herein.

"In arriving at our conclusion, we are not unmindful of the decision in *Matter of Ehrmann*, 267 App. Div. 1022, reversing Appeal Board, 8841-43, affirmed in 293 N. Y. 815. In our opinion, that case is distinguishable from the case at bar in that the premises had been operated as a dairy farm for approximately a quarter of a century. There was evidence also to indicate that at least part of the produce was disposed of commercially. These factors are completely lacking in the instant situation.

"The decision of the referee is affirmed."

Office and Staff Management

A forum for the exchange of views and information on all aspects of the administration of an accounting practice.

STRENUOUS days lie ahead for accountants, due to the problems created by the defense preparation program. The strains may be reduced, or aggravated, by the extent and effectiveness of our own plans to anticipate and meet the problems, or the lack of such measures. Complacency and procrastination will take their toll in time.

Staffs, office and field, must be appraised as to their vulnerability to conscription or voluntary movement into the armed forces or essential industries. Some replacements (older men, women, physically handicapped) should be taken on at once for training; others should be lined up for call as needed and, in the interim, might be given reading assignments and other training to save time later. The abundance of accountants in the lower ranks is expected to disappear soon and be replaced by a shortage, and the shortage in seniors will just get worse. Training programs must be geared for quicker action and a different type of trainee. Seniors and supervisors should be briefed on how to utilize most efficiently the available staff, and review procedures may need some extension to guard against increased hazards due to less experienced staffs and strains and stresses.

Office procedures must be streamlined and brought up to the maximum efficiency. Equipment should be utilized to the fullest extent possible to overcome manpower shortages or costs. Duplicating machines, dictating machines, electric typewriters, and other improved equipment are all very helpful normally, and particularly so in such times.

Tax Department Organization

Though somewhat late, accountants who have not read the articles listed below on how to operate a tax department efficiently, are advised to do so now. Some worth-while ideas may be derived from them which can be used before and after March 15th.

Office Procedures for Controlling the Processing and Filing of Income Tax Returns
—Herbert B. Fischgrund, C.P.A.

Some Hints with Respect to the Assembly of Tax Information and the Preparation of Tax Returns
—Hyman D. Klein, C.P.A.

Both articles appeared in the January, 1949, issue of *The New York Certified Public Accountant.*

Acountants' Signatures on Tax Returns

There is a constant undercurrent of concern or doubt among many accountants regarding the risks they take in signing tax returns in cases where the data has been obtained without audit or after a limited audit. This has resulted in various types of defensive procedures, to wit, additions to the printed affidavits of expressions such as "prepared from unaudited data", etc., use of specially prepared affidavits in lieu of the printed forms, and use of rubber stamps containing protective expressions.

No alteration of the affidavit is necessary, nor need the accountant have any concern if he has not knowingly prepared the return improperly. This is the position taken in a carefully reasoned article in the November, 1950, issue of Taxes, The Tax Magazine, entitled "When You Sign That Return," by Ralph M. Lewis and Norman B. Barker.

Wage Stabilization

Experience with wage stabilization during the last war disclosed that inadequate planning and organization of

employee groups and salary ranges, as well as lack of definite promotion programs, were among the major causes of violations of the law. Inadequate records were another factor in the creation of violations, or in the inability to prove that breaches of the law really did not exist.

From all appearances employers may soon have these problems foisted upon them once more. Accountants will be called upon then, as before, to help such clients as are not able to work out the necessary procedures and records by themselves. Those who have dealt with wage stabilization in the past know that it was not a simple matter and that penalties were very severe.

In anticipation of this development, accountants would do well to re-read the section on wage stabilization contributed by David C. Anchin, C.P.A., in the American Institute of Accountant's refresher course volume entitled "Contemporary Accounting." It may help avoid much grief, waste of time, and penalties.

Disposition of an Accounting Practice by Will

A recent decision by the Appellate Division of the New York Supreme Court, First Department,* brings out a point of interest to accountants who may be wondering how to dispose of their partnership interests in the event of death. In this case, an accountant willed his interest to his associate with the "request" that he pay to the wife of the deceased out of such practice $150 per month for 120 months, if alive.

It appears that the payments were resisted on the following grounds: first, that they were not mandatory and, second, that since an accounting practice had no goodwill value there was no basis for the payments.

The Appellate Division ruled as follows:

"We are of the opinion, construing the will as a whole, that the distinctive language employed by the testator clearly imports an obligation—a legal obligation—by the legatee if he accepts the legacy bequeathed to him to make payment to the widow in the manner therein described."

* * *

"Whether or not the practice of the decedent as a certified public accountant possessed a good will that could be measured in dollars and cents is not directly before us at this time except in so far as the answer thereto might throw light on the intent of the testator.

The following questions still remain unanswered:

1. The Court indicated that the question of whether the decedant's accounting practice had goodwill after his death, and whether the legatee had in fact accepted the legacy subject to the conditions imposed upon it, would be determined upon appropriate proceedings for that purpose.
2. The value placed on the interest in the practice for estate tax purposes.
3. Whether the payments made by the legatee are capital expenditures; and whether they are taxable to the widow.

Follow-up

Regarding monthly luncheon meetings of office and personnel managers at places within walking distance from the office, a number of responses have been received. It is likely that one or two area groups may be able to get under way soon. If interested, just drop a brief note to

The Editor, Office and Staff Management
The New York Certified Public Accountant
677 Fifth Avenue, New York 22, N. Y.

Contributions of ideas and data for inclusion in this column are desired. Names of contributors will not be published if anonymity is requested. Samples of office forms are also solicited for analysis and possible publication.

* *Application of Murray Goodman et al.*, N.Y.L.J., November 9, 1950.

BOOK REVIEWS

(Continued from page 78)

Agency, Partnerships, Corporations, Negotiable Instruments, Bailments, Security, Bankruptcy, Insurance, and under the topic Miscellaneous, Real and Personal Property, Wills and Estates and Trusts. One hundred thirty-eight pages are devoted to Uniform Laws dealing with Documents of Title, Sales, Partnerships, Negotiable Instruments and sections of the National Bankruptcy Act. The balance is made up of questions which appeared on examinations over the past fifteen years, with model answers, and practice problems, the latter following rather closely the text material.

No text material appears on the Law of Taxation, the author explaining that the subject of taxation is "so interrelated with the subject matter of accounting that it is not appropriate for inclusion in commercial law", a reason which would perhaps justify the exclusion of other topics, and that it "requires a study of the most recent material in a continually changing field . . ."

The value of the complete Uniform Laws as part of the volume appears to have been minimized by the failure to refer by section numbers to the pertinent portions of the various acts, at least in the treatment of previous examination questions.

The number of pages of text material devoted to each topic indicates the frequency with which questions under each topic have appeared in past examinations. For example, some sixty-eight questions on the law of Contracts have been asked between November, 1935, and May, 1950. Over the same period twenty-two questions on Bankruptcy and sixteen on Insurance have appeared. One hundred twenty-seven pages of text are devoted to Contracts, while only twenty-one and fourteen pages of text cover Bankruptcy and Insurance, respectively. Accordingly, the amount of text material on each topic appears to be in proportion to the number of questions under the same topic. Moreover, for the most part, the text follows closely the subject matter of the C.P.A. questions. This is unfortunate for the candidate has no guarantee against surprise. Further, the value of the text may be seriously questioned when the same subject matter is adequately covered in answers.

The chief value of the volume lies in the presentation of the C.P.A. questions and answers. The author's model answers are brief, lucid and completely reliable and adequate for a candidate in any particular jurisdiction. One need examine only a few answers to see that the author has set forth a pattern which, if followed by the candidate, should unquestionably satisfy the examiners. A categorical answer is given, where possible, and in giving the reasons for the answer, the general principle of law is stated and its application explained. Of course, variations due to local law are not set forth and, in the main, must be discovered by the candidate himself. In a few instances variation is noted by reference to the "preferable" rule or the "better view." While it cannot be expected that in a work such as this each variation and the substance thereof be noted, yet it is reasonable to expect that where local statutes have affected a fundamental principle or concept, the candidate be warned to check for such changes. For example, in answer to certain questions on consideration in the law of contracts, it might well have been stated generally that several local statutes have been enacted dispensing with the requirement of consideration in certain instances.

On the whole this volume will prove an invaluable aid to candidates for the examination.

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